FULL COMMITTEE HEARING ON LIABILITY REFORM AND SMALL BUSINESS

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CONTENTS

OPENING STATEMENTS

	Page
Velázquez, Hon. Nydia M.	1
Chabot, Hon. Steve	2
Braley, Hon. Bruce	3

WITNESSES

PANEL

Rickard, Lisa A., U.S. Chamber of Commerce	6
Harned, Karen R., National Federation of Independent Business Legal Foundation	7
Kelly, Steve, National Lumber and Building Material Dealers Association	9
Freedenberg, Dr. Paul, Association for Manufacturing Technology	12

APPENDIX

Prepared Statements:

Velázquez, Hon. Nydia M.	33
Chabot, Hon. Steve	35
Altmire, Hon. Jason	37
Braley, Hon. Bruce	38
Rickard, Lisa A., U.S. Chamber of Commerce	40
Harned, Karen R., National Federation of Independent Business Legal Foundation	52
Kelly, Steve, National Lumber and Building Material Dealers Association	65
Freedenberg, Dr. Paul, Association for Manufacturing Technology	68

Statements for the Record:

U.S. Chamber Supplements - NEERA and Harris Studies	76
American Bar Association	107
AFL-CIO Correspondence	124
American Tort Reform Association	126

FULL COMMITTEE HEARING ON LIABILITY REFORM AND SMALL BUSINESS

THURSDAY, MAY 17, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:30 a.m., in Room 2360 Rayburn House Office Building, Hon. Nydia Velázquez [Chairwoman of the Committee] presiding.

Present: Representatives Velázquez, González, Grijalva, Cuellar, Braley, Ellsworth, Johnson, Sestak, Chabot, Akin, Musgrave, Westmoreland, Heller, Davis, Fallin, Buchanan and Jordan.

OPENING STATEMENT OF CHAIRWOMAN VELÁZQUEZ

ChairwomanVELÁZQUEZ. Good morning. I call this hearing to order on the issue of liability reform and small businesses.

I would like to thank Ranking Member Chabot for bringing this issue to the Committee and arranging for the witnesses to testify. The issue of civil liability is clearly something that impacts small businesses in a variety of ways. I think we can all agree that frivolous lawsuits harm small businesses and our economy. No one will ever defend that practice.

However, in order to have a discussion about liability reform, we must consider whether changes in federal law could have an impact on legitimate rights of action in addition to stopping frivolous suits.

For today's hearing, the issue of liability reform must be considered in light of the many roles that small businesses play. Not only they are manufacturers, but small firms are oftentimes the consumers and sellers of products. Our legal system must ensure that the rights of entrepreneurs are protected, both as the plaintiff or defendants in lawsuits.

The economy depends on the ability of companies to protect their contractual rights, including their relationships and transactions with other businesses. I do understand, however, that we will hear about how our current legal system has its shortcomings. If our tort system is not used properly, it can and does impose costs on businesses, many times unfairly.

Determining the extent of these costs is difficult and figures are often disputed. My hope is that we can open up the debate today beyond litigation costs and examine the different factors that may be driving up overall liability insurance premiums. According to a

study by the National Federation of Independent Business, small business owners rank liability insurance as one of their top concerns. Lawsuit abuse is near the bottom of that list.

These findings suggest there are a number of factors contributing to liability costs, including insurance company practices. As such, I believe that any approach to addressing liability issues must be multi-pronged and go beyond simply limiting the ability to sue. The states that have successfully handled overall insurance costs have enacted both tort reform and insurance reform.

A number of years ago, California addressed soaring insurance costs by passing Proposition 103. Proposition 103 required that insurance companies roll back rates and file an application with the Insurance Commissioner to increase rates. Companies were also required to hold public forums before raising premiums. Studies show that this was a primary driver in reducing insurance costs in the State.

A similar approach is needed to help small businesses with rising liability insurance costs. To truly get at the major problems behind these prices, there must be greater transparency in insurance markets. While I know many of the witnesses have focused their testimony on litigation, I will be interested in hearing about their experience with insurance companies when it comes to overall liability coverage.

While not always perfect, our nation's justice system is the best in the world. There is room for improvement, but we need to keep in mind that lawsuits can serve to protect honest small business owners who are doing the right thing. A working legal system will ensure that the products that companies manufacture are safe, yet affordable to produce. A functioning system fosters competition in terms of safety by rewarding company for manufacturing safe products while penalizing those who cut corners.

I look forward to today's testimony, and I thank the witnesses for their participation.

I now recognize Ranking Member, Mr. Chabot, and, yes, for the purpose of his opening statement.

OPENING STATEMENT OF MR. CHABOT

Mr.CHABOT. Thank you, Madam Chairwoman, and I want to sincerely thank you for holding this important hearing in which we will look at how the tort system is impacting our nation's small businesses. We will also review some liability reform measures that would allow small business owners to focus their energies on growing their businesses and creating jobs, rather than worrying so much about fighting frivolous lawsuits.

I also want to thank our panel of witnesses for being here today. It is a very accomplished panel of experts who have been dealing with this issue for a long time. I am sure everyone up here will benefit from your testimony today, so thanks again for coming.

Small businesses are the backbone of our nation's economy, yet small businesses are bearing the brunt of the increasingly litigious nature of our nation. Small businesses pay 69 percent of all business tort liability costs—that comes to about $100 billion annually—but take in only 19 percent of all business revenues. Think about that.

Small businesses are responsible for less than one-fifth of the business revenues but pay more than two-thirds of the liability costs. That is unfair. It is not good for the economy, and it is not good for consumers either, who have to pay more for goods and services as a result of frivolous litigation.

Let me mention here a few pieces of legislation that I think that we are now looking into and should in the near future. Mr. Boren, a Democrat of Oklahoma, and I have introduced the Innocent Sellers Act. The Innocent Sellers Act would simply change the law so that sellers do not take on liability for a product merely by selling the product.

If sellers are negligent with respect to certain specific non-sale activities, they would be responsible for the harm that their negligence causes, but nothing more. Another area of product liability reform where small businesses need some relief is in the area of durable goods manufacturing. Unfortunately, previous Congresses have failed to deliver a much needed product liability reform bill.

During the last few sessions of Congress, I have introduced legislation, The Workplace Goods Product, Job Growth, and Competitiveness Act, that would benefit small businesses, consumers, and workers by creating a nationwide 12-year statute of repose for durable goods. This would simply recognize that durable goods that have performed capably in the workplace for 12 years or more work. After that point in time, manufacturers should not be held liable for an obsolete or modified machine tool. It is an issue of fairness, and it is an issue of common sense.

Next week I plan to reintroduce the Small Business Liability Reform Act that NFIB, among others, has worked so diligently on. This bill would strengthen the evidentiary standard on claims made against small businesses, providing some much needed reform to our nation's tort laws.

Common sense liability reform is important for small businesses who make and sell products, as well as to consumers who end up paying higher prices as a result of frivolous lawsuits.

Let us see here. I want to thank, again, the panel, and I especially want to thank you, Madam Chair, for holding this hearing today, and our other colleagues that will be working on this in the future.

I yield back.

ChairwomanVELÁZQUEZ. Thank you. And now I recognize Mr. Chabot for the purpose of introducing the witnesses.

Mr.BRALEY. Excuse me, Madam Speaker, point of order, or Madam Chairwoman.

ChairwomanVELÁZQUEZ. Yes?

Mr.BRALEY. Will there be other opening statements permitted at the hearing?

ChairwomanVELÁZQUEZ. Oh, definitely. Do you want to make an opening statement? The gentleman is recognized.

OPENING STATEMENT OF MR. BRALEY

Mr.BRALEY. Madam Speaker, for over 20 years, powerful special interests have attempted to restrict or rescind the constitutional rights of workers and consumers injured by unreasonably dan-

gerous and defective products, often through well financed campaigns of half-truths and misinformation.

Today's hearing is just another sad example of attempts to trample the Constitutional rights of American citizens under the guise of shifting the human cost for these dangerous and defective products from the insurers of the sellers to the injured or deceased consumer and the taxpayers of this country.

It should come as no surprise to anyone in this room that the driving force behind this assault on our Constitutional rights is a coalition made up of the most powerful business lobbying groups in this country. A quick review of the top corporate spenders on lobbying from 1998 to 2006 is a veritable Who's Who of Corporate Tort Reform Advocates? The U.S. Chamber of Commerce has spent $317 million on lobbying in that period; the American Medical Association, $156 million; the Pharmaceutical Research and Manufacturers of America, $104 million; and Philip Morris, $75 million.

At the head of the list, high above the rest of the crowd, stands the U.S. Chamber of Commerce. According to recent reports, the U.S. Chamber spent 83 percent more on lobbying in 2006 than in 2005, spending a whopping $72.7 million on federal lobbying, up from $39.8 million in 2005.

In comparison, the overall spending on lobbying activities increased by only 1.7 percent in 2006. This startling disparity should cause this Committee serious concern, particularly when that advocacy is part of a long and persistent effort to deprive consumers who have suffered catastrophic injuries or death from receiving fair compensation.

According to a national journal article published on its web site, over the past eight years the U.S. Chamber's Legal Institute has spent over $101.5 million on federal lobbying for so-called tort reform. Madam Chairwoman, it is time to look below the surface of the hype and the hyperbole and focus on facts.

Here are some important facts to consider during today's hearing. Fact: statutes of repose do nothing to reduce or eliminate frivolous lawsuits. A frivolous lawsuit is, by definition, a case without any merit. Statutes of repose put up an artificial barrier to cases with merit by cutting off valid claims arising from the sale of defective products that were unreasonably dangerous at the time they were manufactured.

Fact: many manufacturers and sellers of products represent to consumers that their products are intended to last for many years, including years beyond the cutoff date for legitimate claims contained in the statute of repose. Fact: caps on damages do nothing to reduce or eliminate frivolous lawsuits. In fact, caps only punish those individuals with catastrophic injuries or death claims by depriving them of the full compensation they should be entitled to under the law.

The net result of caps is to shift the burden of the injury from the responsible party to the injured or deceased consumer and their family and to U.S. taxpayers who frequently end up providing lifetime medical and disability benefits when the wrongdoer is not held accountable for the damages.

Fact: the best way to protect sellers of defective and unreasonably dangerous products is to provide clear rights of indemnifica-

tion from the manufacturers of those dangerous and defect products, clear and efficient means of holding the growing number of foreign manufacturers of defective products accountable for the harm they cause in this country, and to make sure that consumers receive adequate warnings about the risk of using the product and the true intended useful life of the product.

The truth is that product liability laws have been making America safer for over 100 years. And making sure that parties responsible for introducing defective products that are unreasonably dangerous into the stream of commerce are held responsible to the people who are seriously injured or killed by those defective products. That is a good thing that promotes responsibility and prevents cost-shifting to U.S. taxpayers who always get stuck with the tab when the responsible party escapes liability for the full extent of the damages caused.

One final word about tort reform, Madam Chairwoman. Over 100 years ago when defective products were maiming and killing workers and consumers on a daily basis as part of the Industrial Revolution, we used the word "reform" to reflect changes that expanded the protection of individual rights and encouraged greater responsibility on the part of the wrongdoer.

It is a sad comment on our times today that the word "reform" is associated with a well-financed movement to strip away Constitutional rights and immunize corporate wrongdoers who place unreasonably dangerous and defective products into the stream of commerce.

I yield back the balance of my time.

ChairwomanVELÁZQUEZ. Is there any other member who wishes to make an opening statement?

[No response.]

Okay. So now I recognize Ranking Member Chabot for the purpose of introducing the witnesses.

Mr.CHABOT. Thank you very much, Madam Chair. And I would just note I appreciate the gentleman's spirited opening statement there, and I won't respond to everything that he said, but I would just note if you want to—he started out by talking about lobbying dollars and campaign dollars, etcetera, being spent. I can assure you that the trawlers have been no slackers in that area.

Our first witness that we have is Ms. Lisa Rickard. Am I pronouncing that right? Excellent. Nobody ever pronounces my name right, so I am glad I got yours—Rickard. President of the U.S. Chamber Institute for Legal Reform. Ms. Rickard has been at this post since March 2003. She spent over 25 years as a public policy advocate, most recently as Vice President, Federal and State Government Affairs, for the Dow Chemical Company. Previously, she was Senior Vice President, Federal and State Government Relations, for Rider Systems, Inc.

Ms. Rickard was a partner in the Washington, D.C. law firm of Akin Gump Strauss Howard and Feld, where she represented corporate and public sector interests before Congress, the White House, and regulatory agencies. She has also worked in the offices of former Senators Frank Murkowski and Richard Stone, and we welcome you here this morning for your testimony.

STATEMENT OF MS. LISA A. RICKARD, PRESIDENT, U.S. CHAMBER INSTITUTE FOR LEGAL REFORM, U.S. CHAMBER OF COMMERCE

Ms.RICKARD. Thank you very much. Good morning. I am pleased to be here on behalf of the U.S. Chamber Institute for Legal Reform, and the U.S. Chamber of Commerce, which is the world's largest business federation representing more than three million businesses and professional organizations.

The Institute for Legal Reform, or ILR, was formed in 1998 with the mission of making America's legal system simpler, fairer, and faster for everyone. I would request that a copy of my full testimony and the attached studies be included for the record.

ILR released two new studies today examining the impact of lawsuits on small businesses. First, we asked the non-partisan market research firm of Harris Interactive to survey the owners of small businesses, defined as those with less than $10 million in annual revenues, to determine how the lawsuit system affects their business decision making.

The results are quite startling, particularly when you consider that they reflect the views of 2.8 million small business owners with $2.3 trillion of annual output, nearly 20 percent of the nation's GDP. Six in 10 of the qualified respondents say the threat of unfair lawsuits has caused them to make decisions to avoid litigation, decisions such as taking products off the market and cutting employee benefits.

Sixty-two percent also say that they could increase revenues if they felt that they would be protected from lawsuit abuse, and they would largely reinvest these additional revenues in buying new equipment, increasing wages and benefits, or in hiring new employees. The second study conducted by NERA Economic Consulting shows that there is no sector of the economy harder hit by lawsuit abuse than America's small business owners.

Of the $143 billion U.S. businesses paid in tort costs in 2005, NERA found that small businesses paid an astounding $98 billion. That translates into $200,000 a year for a business with $10 million in annual revenues. What is even more astonishing is that many of these small businesses pay a significant share of their liability costs out of pocket, rather than through insurance coverage. That drains financial resources critical to their continued survival and growth.

But behind the statistics are real people and real businesses suffering because of our lawsuit-happy culture. Some of these real people are here today. Dennis Harrington joins us from Springfield, Illinois, where he owns and operates a giant slide enjoyed by kids of all ages at local fares. He has been the subject of several lawsuits filed by individuals who have ridden the slide.

The result: not only have his legal expenses and liability insurance increased, but he had to purchase video surveillance equipment to monitor the riders, so he could defend himself against future lawsuits.

Also joining us today from Los Angeles is Chris Moser, owner of Network 54, a small Los Angeles based Internet startup with two employees. The company is among the few Internet startups to survive the dot-com crash. However, Chris' company almost didn't sur-

vive a frivolous lawsuit. In 2005, Network 54, together we Deutchebank, Commerzbank, and John Hancock Insurance was sued for $800 million for allegedly defaming a former strawberry farmer who makes his living trying to collect from banks on World War I era German gold bonds.

Incidentally, the plaintiff's lawyer in this case had earned quite a reputation for launching creative lawsuits. He sued the U.S. National Oceanic and Atmospheric Administration for failure to predict the 2004 Indian Ocean tsunami. Network 54 was eventually dropped from the case, and the underlying claim was ultimately dismissed. Still, this wholly frivolous lawsuit cost Network 54 legal fees and not to mention the time and attention it took Chris away from operating his business.

Unfortunately, these stories are not isolated incidents. Similar stories could be told by tens of thousands of small business owners who are victimized by lawsuit abuse each year. The simple fact is this: our lawsuit system is a serious problem for America's small businesses, costing jobs, and dampening the spirit of entrepreneurship and innovation at the very core of America's greatness.

On behalf of the U.S. Chamber Institute for Legal Reform, and the U.S. Chamber of Commerce, I urge you and your fellow members of Congress to take action to pass vital legal reforms, reforms that will safe American jobs and strengthen America's small businesses, the backbone of the nation's economy.

Thank you.

[The prepared statement of Ms. Rickard may be found in the Appendix on page 51.]

ChairwomanVELÁZQUEZ. Thank you.

Now, Mr. Chabot will introduce the next witness.

Mr.CHABOT. Thank you, Madam Chair. Our next witness is Ms. Karen Harned, Executive Director of the NFIB, National Federation of Independent Business Legal Foundation. Ms. Harned has strong experience fighting for small business.

As an associate at Olsson, Frank and Weeda, P.C., she specialized in food and drug law and represented several small businesses and their trade associations before Congress and federal agencies. She also worked as an Assistant Press Secretary for former U.S. Senator Don Nichols.

Ms. Harned received her B.A. from the University of Oklahoma in 1989, and her J.D. from George Washington University Law School in 1995. And we welcome you here this morning, Ms. Harned.

STATEMENT OF MS. KAREN R. HARNED, ESQ., EXECUTIVE DIRECTOR, NATIONAL FEDERATION OF INDEPENDENT BUSINESS LEGAL FOUNDATION

Ms.HARNED. Thank you, Madam Chairwoman, and distinguished Committee members. My name is Karen Harned, and I serve as Executive Director of the National Federation of Independent Business Legal Foundation, the legal arm of NFIB. NFIB is the nation's leading small business advocacy group, and our typical member has five employees and gross sales of $350,000 a year.

We applaud the Committee for holding this hearing on the negative effects our sue first culture is having on small business and the need for liability reforms. Small business ranks the costs and availability of liability insurance as the number two most important problem facing small business. The only problem that is ranked higher is the cost of health care.

Many small businesses fear getting sued, even if a suit is not filed. For the small business with five employees or less, the problem is the $5- and $10,000 settlements, not the million dollar verdicts. When you consider that many small businesses gross $350,000 or less a year, which does not include additional expenses of running the business, like payroll, rent, costs of goods sold, and regulatory costs, $5- to $10,000 can significantly impact a small business owner's bottom line.

Recent press attention and public outrage has focused on the outlandish $65 million lawsuit filed against a District of Columbia dry cleaner for a missing pair of pants. Plaintiff and attorney Roy Pearson is suing a family-owned dry cleaner for a lost and found pair of pants. The owner has attempted to settle with Pearson. However, he refused, and instead brought a suit claiming that the shop was in violation of D.C. consumer protection laws.

He alleges the cleaner's satisfaction guaranteed and same-day service guarantee were not met, and, therefore, they are liable for $1,500 per day per violation per person, by using the owner, his wife, and their son, tacking on $500,000—or, I am sorry, for suing the owner, his wife, and their son, tacking on $500,000 for emotional damages, over $540- in legal fees, although Mr. Pearson is representing himself, and $15,000 for 10 years' worth of weekend car rentals.

Pearson is claiming he is owed over $65 million. As outrageous as the facts of the suit are, it is not outrageous that the defendant is a small business. Small business is the target of lawsuits, because trial lawyers understand that they are more likely than a large corporation to settle a case rather than litigate one.

Small businesses do not have in-house counsel to inform them of their rights, write letters responding to allegations made against them, or provide legal advice. They do not have the resources needed to hire an attorney, nor the time to spend away from their business fighting many of these lawsuits. And often they do not have the power to decide whether or not to settle a case; the insurer makes that decision.

I place frivolous lawsuits into four categories—you look like a good defendant, pay me now or I will see you in court, somebody has to pay and it might as well be you, and Yellow Page lawsuits. You look like a good defendant—a prevalent form of lawsuit abuse—is when plaintiffs or their attorneys are merely trolling for cases.

The plaintiff or attorney will travel from business to business looking for violations of a particular law. In such cases, the plaintiff generally is not as concerned with correcting the problem as he or she is in extracting a settlement from the small business owner.

Pay me now or I will see you in court—an increasingly popular tool is the demand letter. Demand letters allege the small business violated a federal or state statute and are replete with legal cites.

At some point, the letter says that the small business has an opportunity to make the whole case go away by paying a settlement fee up front and provides timeframes for paying the fee. If these demands are not met, the letter threatens a lawsuit.

Somebody has to pay and it might as well be you—this is where the plaintiff may have been harmed but is suing the wrong person. For example, the plaintiff sues a small business leasing a strip mall for a personal injury accident that occurred in the parking lot.

Yellow Page lawsuits—in these cases, hundreds of defendants are named in a lawsuit, and it is their responsibility to prove they are not culpable.

Legislation is sorely needed to reform our nation's civil justice system. Since 1993, Rule 11 has been hamstrung by changes that diluted its ability to prevent frivolous lawsuits. In order to help restore fairness to the legal system, Congress should pass legal reform that makes Rule 11 sanctions mandatory for frivolous lawsuit filers.

NFIB also supports legislation that would prevent frivolous food lawsuits, reform our nation's product liability laws, close the loophole in the Equal Access to Justice Act, curb excessive punitive damages awards, and abolish joint and several liability.

Thank you for asking us to testify today.

[The prepared statement of Ms. Harned may be found in the Appendix on page 63.]

Mr.CHABOT. Thank you very much. We appreciate that.

Our next witness will be Mr. Steve Kelly, Chairman of the National Lumber and Building Material Dealers Association. This particular association represents 8,000 lumber and building material dealers, the largest regional chains across the United States, 20 state and regional associations, and the industry's leading manufacturers and service providers.

Mr. Kelly is also President and Owner of Kelly Brothers Lumber Company. They have three locations and are based in Covington, Kentucky.

And we welcome you here this morning, Mr. Kelly.

STATEMENT OF MR. STEVE KELLY, CHAIR, NATIONAL LUMBER AND BUILDING MATERIAL DEALERS ASSOCIATION, PRESIDENT, KELLY BROTHERS LUMBER, COVINGTON, KENTUCKY

Mr.KELLY. I want to begin by thanking Madam Chairwoman, as well as Ranking Member Chabot, for holding this hearing today to examine an issue that impacts nearly every small business, namely the threat of lawsuits. I commend you for exercising your oversight duties to learn how unfounded lawsuits harm small businesses and depress our economy.

As he said, I am Steve Kelly. I am Owner and President of Kelly Brothers Lumber in Covington, Kentucky. It is a family-owned business and have operated for 60 years. We employ 42 employees and serve homeowners and professional contractors in Kentucky, Ohio, and Indiana.

As he said, I currently serve as Chairman of the National Lumber and Building Material Dealers Association. We represent 8,000

lumber and building material dealers, 20 state and regional associations, and industry leading manufacturers and service providers.

NLBMDA's members and their 400,000 employees supply the majority of building products sold in the United States to professional contractors, home builders, and remodelers. Madam Chairwoman, I am here today to highlight the impact that predatory lawsuits have on the building supply industry.

Most lumber yards and building suppliers are small family-owned businesses which operate in the very communities in which the esteemed members of this Committee sit and reside. They pay taxes, sponsor charitable events, and participate in community activities. Here is the problem: unfounded and unfair lawsuits are increasing, and they are having a negative affect on the ability of lumber dealers to operate our businesses.

A 2005 survey of NLBMDA members found that approximately one in four have been the victim of a product liability lawsuit within the previous five years. And in almost every one of those cases, the dealer did not design, manufacture, alter, or install the product. Our current liability system holds each party in the product supply chain liable for any defects or harm caused by the product without any finding of fault.

Liability is not assigned in a fair and consistent way. A building material dealer who simply sells a product should not be burdened with 100 percent of the liability when the product fails. Let me offer a few examples to illustrate how the current system punishes small business owners like me.

A dealer in Ohio sold slate-style shingles to a customer. The shingles were shipped directly by the wholesaler to the job site. The dealer never saw or touched the product. The coating later wore off some of the shingles, resulting in a spotty appearance, and they dealer was forced to pay thousands of dollars in a settlement.

Another dealer sold bricks manufactured independently of the dealer and delivered directly to the customer. The dealer was named a co-defendant in a lawsuit claiming manufacturing defects and encouraged by his insurance company to settle the case to avoid a court battle. In Texas, a lumber dealer sold a 2x10 24-foot board to a contractor who used it for scaffolding.

While two people were standing on the board, the board broke. One of the individuals was able to catch himself, but the other one fell and was hurt. They are suing the lumber company for selling them a defective board, even though it was never suitable for scaffolding purposes. The case is still pending and has already cost the lumber dealer thousands of dollars to defend.

These are just a few of the lawsuits occurring in our industry where innocent sellers are forced to spend time and money defending themselves for actions outside of their control. Fortunately, there is a solution to this problem. Ranking Member Chabot, a long with Representative Dan Boren, has introduced legislation to assign liability on a proportionate basis.

Innocent Sellers Fairness Act, H.R. 989, would protect sellers from predatory lawsuits by removing liability if they merely supplied the product and had no part in the manufacturing, design, or installation. The bill would hold sellers responsible only in propor-

tion to their wrongdoing, freeing them from liability when they have done nothing wrong.

Innocent Sellers Fairness Act is necessary because current law imposes liability without wrongdoing by sellers, exposing them to all the damage allegedly suffered by a plaintiff, even though other defendants may have played a much greater role in causing the damages. The mistake may have been in the manufacture or design of the product or even in the customer's improper use of the product, but somehow the seller is stuck with some or all of the liability.

Often sellers choose to settle a case to avoid the uncertainty of trial outcome and the bad press that often follows. The current system does not do enough to protect the truly innocent. The Innocent Sellers Fairness Act would restore common sense to the legal system.

Congressman Chabot, on behalf of the NLBMDA and innocent sellers around the country, I want to thank you for your leadership in fighting unfair lawsuits and championing legal reform. I look forward to working with this Committee to address these problems and ensure that America's small businesses operate in a legal environment that is fair for everyone.

Thank you, Madam Chairwoman, for the opportunity to be here today.

[The prepared statement of Mr. Kelly may be found in the Appendix on page 48.]

Mr.CHABOT. Thank you, Mr. Kelly. And our last witness, our final witness this morning, is Dr. Paul Freedenberg, who is Vice President of Government Relations at AMT, the Association of Manufacturing Technology.

Dr. Freedenberg has had a long and distinguished career in both the private and public sector. He began his public service in the office of former Senator Jay Bennett Johnston, before moving on to work for the late Senator John Heinz as well as former Senator Jake Garn.

He also served as Staff Director of the Senate Banking Committee's Subcommittee on International Finance. Dr. Freedenberg was then appointed by President Reagan as the first Undersecretary for Export Administration at the Department of Commerce. Following his government service, Dr. Freedenberg was an international trade consultant with the law firm of Baker and Botts, LLP, in Washington, D.C.

He specialized in general international trade issues, as well as technology transfer, export licensing, export finance, export enforcement, and both foreign and domestic banking and investment issues.

And, Dr. Freedenberg, we welcome you here, and you are recognized for five minutes.

STATEMENT OF DR. PAUL FREEDENBERG, VICE PRESIDENT, GOVERNMENT RELATIONS, ASSOCIATION FOR MANUFACTURING TECHNOLOGY

Mr.FREEDENBERG. Thank you very much. Madam Chairwoman, and members of the Committee, thank you for holding the hearing today and for giving me the opportunity to participate.

My name is Paul Freedenberg. I am Vice President for Government Relations at AMT. AMT is a trade association whose membership represents over 400 manufacturing technology providers located throughout the United States, almost the entire universe of machine tool builders who operate in this country. Most of these companies are small. An estimated 78 percent of them have less than 50 employees, but their contribution is huge.

They are the ones who build the machines that make things work. In fact, everything in this hearing room, except the people of course, was either made by a machine tool or by a machine made by a machine tool.

AMT has testified many times over the years before this and other committees on the need for product liability reform, and that is what I would like to do again today. For most small American businesses, and specifically for our members, product liability is not a distant issue but one that can literally make or break our companies.

Several AMT members have been forced to close their doors because of product liability lawsuits. Others are in danger of closing because litigation costs are strangling them. They are spending money not on hiring more workers or improving productivity, but rather on defending against lawsuits involving machines that are often older than anyone in this room.

AMT estimates that the average age of machine tools has climbed from 10 years in 1998 to nearly 13 years in 2005. The reason is largely because when a factory decides to invest in new capital equipment, the old machinery is usually not disposed of. When companies can't afford new machines, they purchase these overage machines, often altering them to fit their needs.

This process is repeated as newer machines are acquired and older ones resold. The result is a big overhang of overage machine tools in the U.S. market, and this exposes the manufacturers of the old equipment to costly litigation.

One reform that could significantly help to reduce those crippling costs, Madam Chairwoman, would be the creation of a statute of repose for workplace durable goods.

In many states today, thanks to product liability law, the potential liability for my industry's products is endless, literally forever. Many of these machines are built before OSHA was created, before Neil Armstrong walked on the moon, indeed before The Beatles came to America. They are still in use today.

Although these machines were built decades ago to safety standards of their day, although they are likely to pass through several owners each of whom is likely to have made modifications to accommodate their needs, they are still the subject of four-fifths of our industry's lawsuits. This kind of litigation is disproportionately expensive and unproductive. It is a drain on financial resources,

not only from the adverse verdicts but from the costs of a successful defense.

The reality is that most cases involving overage machines never go to trial. And if they do, a jury almost always finds for the defendant. And in those few cases they do go to trial, and where the jury finds for the claimant, the judgment can force a company to close its doors.

I was asked for an example. Well, in 1996, a $7.5 million verdict involving a machine built in 1948, 50 years earlier, was—the judgment—the verdict was found against Madison Technologies, a 100-year old Illinois machine tool builder, but it led to that company's bankruptcy.

However, when these lawsuits are won, the litigation, nevertheless, results in unnecessarily high legal and transaction costs. No matter how frivolous the actual facts, the claimant's pleadings must be answered, the depositions taken, design experts consulted, historical records unearthed and evaluated. The result is a substantial expenditure of funds and additional litigation in our courts.

This kind of open liability can lead to legal extortion, in which baseless suits are filed by entrepreneurial lawyers who are banking on the fact that many companies and/or their insurers will settle out of court.

Madam Chairwoman, our machine tool builders, particularly our small ones, just can't afford this kind of unfair liability at a time when they are facing serious and increased competition from foreign companies whose liability is relatively small. That is because many of them are—recently came to the United States.

Enactment of the statute of repose for workplace durable goods would significantly level the playing field for U.S. manufacturers and achieve the uniformity and certainty necessary to produce the state of art products for which we are noted.

Madam Chairwoman, some years ago, the Reagan administration, and then the first Bush administration, at the urging of 250 members of Congress, provided import relief for our machine tool industry based on the threat to our national security and defense industrial base from Asian machine tools. These administrations did so because they recognized that a strong machine tool industry is vital to America's military and economic security.

ChairwomanVELÁZQUEZ. Dr. Freedenberg?

Mr.FREEDENBERG. Yes.

ChairwomanVELÁZQUEZ. I would like to call the attention to the fact that your time expired. If you can—

Mr.FREEDENBERG. Okay. Fine. I will finish in one paragraph.

Same is true today, and enactment of meaningful reform, including a statute of repose, could significantly increase the competitiveness of U.S. companies, particularly small companies, and ensure that no injured worker goes uncompensated. I appreciate the Committee's attention to this issue.

Thank you.

[The prepared statement of Mr. Freedenberg may be found in the Appendix on page 40.]

ChairwomanVELÁZQUEZ. Thank you, sir.

Mr. Kelly, thank you for the witness' testimony, and now we are going to open up this for the members to be able to ask questions.

My first question is addressed to Mr. Kelly. Mr. Kelly, it is important to get to the bottom of what is driving the increasing costs of liability insurance. While litigation may be a factor, it seems that there are other factors at play. In my opening statement, I make reference to the fact that in 1988 California passed Proposition 103.

And Proposition 103 required insurance companies to roll back rates and file an application within Insurance Commission whenever they intended to raise them. My question to you is: to what extent could a similar federal law work to reduce rates?

Mr.KELLY. I am not sure. I am not an insurance agent or in the insurance business, so I really couldn't answer that. But we will get back to you with an answer, a written answer, from the association.

ChairwomanVELÁZQUEZ. Yes. If there is any other witness who—so you don't consider that reducing the rate of insurance cost for small businesses will have anything to do with this, based on the experience in California?

Ms.RICKARD. I do not have experience in this, so I can't—I am not steeped in insurance law. I can't respond to that. The one thing I could respond to—

ChairwomanVELÁZQUEZ. No, no. Okay. That is it, because I have only five minutes.

Now, yes, Ms. Harned, I was listening to your testimony, but I don't know if I missed this fact, and I would ask you—in your testimony you talked about the survey of small businesses that showed that the problem of costs and availability of liability insurance has been a top concern. But also, the problem of cost and frequency of lawsuits is near the bottom of the list. Did you mention that in your opening statement, since you represent NFIB?

Ms.HARNED. No, because—I see what you are saying, but I have to tell you that, again, it is really the $5- and $10,000 settlements that are like a death of 1,000 cuts for small business owners, much like regulatory costs, in that you have to look at the overall picture on this.

We hear from small business owners often on suits that they have—

ChairwomanVELÁZQUEZ. Fine. Fine.

Ms.HARNED. —and trial lawyers that are going after—

ChairwomanVELÁZQUEZ. My question is: you come here to talk about small businesses. You represent NFIB, and you love to release surveys on different issues. On this issue, you conducted a survey that shows that costs and frequency of lawsuits is near the bottom of the list for small businesses. So my question is: do you think part of the explanation for this disconnect is that insurance companies are driving the increases in liability premiums as opposed to litigation costs?

Ms.HARNED. I do think that insurance plays a role in this, but I also have to tell you that a survey that we did in 2005 shows that now 69 percent of small business owners are consulting—have consulted an attorney in the past year. They are having to use—

ChairwomanVELÁZQUEZ. But those are the same—

Ms.HARNED. —attorneys more than ever before.

ChairwomanVELÁZQUEZ. —those are the same businesses who you surveyed and say that was not at the bottom of the—that that was at the bottom of the list.

Ms.HARNED. Madam Chairwoman, respectfully, that was a year later. We do perform the problems and priorities survey every four years. It will be interesting to see how the next one turns out, but I have to say our most recent does show an increased usage of attorneys by small businesses.

ChairwomanVELÁZQUEZ. I will go to Mr. Chabot, and then I will come back and ask more questions, but I will allow for other members to make their questions first. Go ahead.

Mr.CHABOT. Thank you, Madam Chair. If you don't mind, I am going to defer and let Mr. Buchanan ask questions at this time, if that is appropriate.

Mr.BUCHANAN. I want to disclose up front I have been in business 30 years. I was also Chairman of the State Chamber of Florida. We represent 137,000 businesses.

One thing they talked about on the—and I will say also lawyers have created a lot of value for me over the years, so I want to make sure that is up front. But I can tell you, in the State of Florida, that the trial bar is very organized, much more than the business community in terms of funding and being organized, in terms of Tallahassee.

Do you have any sense, Ms. Rickard, what the trial bar spends? It was represented what the business community spends. Do you have any idea what the trial bar spends and trial lawyers and the Federal Government, or in terms of their lobbying activities, or various states?

Ms.RICKARD. I don't have specific statistics, but it is much more difficult to capture the spending of trial lawyers because they are individual contributions, Congressman. It is in the hundreds of millions of dollars. You can't just look at the contribution from the National Trial Lawyers Association. You have to look at contributions from individual lawyers, which are very high, to the degree that we have tracked them, at the state level as well as at the federal level.

Mr.BUCHANAN. One other thought that doesn't get talked about much, but I know in our area a firm in Tampa spends $10 million a year in solicitation. And their ad basically says, "If you don't get anything, you don't pay anything." And that is widespread with a lot of trial lawyers in the State. And there are a lot of good trial lawyers, and I believe people need their day in court, but there are a lot of predatorial practices.

Has that ever been considered, what the amount trial lawyers spend on the back of Yellow Pages, TV ads, newspapers? It is gigantic. Just one law firm spends $10 million. That is his number—John Morgan for the People. Has anybody looked at that? Because we have created a sue happy, you know, way to get rich; try the lottery first, second sue.

Ms.RICKARD. What I would say is that, first of all, we do believe that people need to have their day in court. This is not an issue of not having people who have valid claims have access to the

courtroom. Second of all, I do think that one of the most troubling problems is the use of contingency fees.

The President just issued an Executive Order yesterday prohibiting the use of contingency fee lawyers for Federal Government agencies. It is a problem, and what you do see is continued advertising for plaintiffs. All you have to do is turn on the TV around 11:00 at night, and there are a myriad number of ads out there. So one of the things I think that could be addressed here is dealing with the use of contingency fee lawyers.

Mr.BUCHANAN. But, Ms. Harned, let me ask you—again, 90 percent of the 137,000 people in the Florida Chamber are 15, 20 employees or less. You hear the stories all the time. One lawsuit, two lawsuits, put a lot of these people out of business. Has that been your experience?

Ms.HARNED. Yes. In the instances where small business owners are sued, I mean, one lawsuit can kill them, especially, as I reported, you know, our members typically only gross $350,000 a year. That is not much money. And, in fact, there is a gentleman in California that recently was put out of business—that comes to mind—because of a trial attorney that had made a cottage industry in trying to enforce one statute out there. And as a result, he just closed his doors.

Mr.BUCHANAN. Mr. Kelly, you know, I have been in business, again, 30 years, and have been a small business person for most of my time through that period of time. It seems like the first 15 years there wasn't as much litigation. It just seems since they started advertising, more advertising in the last 15, 20 years, it has just—the proliferation of litigation of frivolous lawsuits have gone out of control.

Have you found that in your industry, or what is your thoughts on it?

Mr.KELLY. Yes. It has been very true in our industry. I give just a few examples today, but it happens constantly. The results showed one in four in the last five years have been sued—the lumber dealers—and that is because of the fact of this advertising. You know, I believe we have become a sue happy country. Makes it an easy way to get a dollar. If something goes wrong, it is easier to blame someone else than to take the blame yourself, even if you—it was your fault. There is always someone out there who is willing to pay.

Mr.BUCHANAN. I have no further questions. Thank you.

ChairwomanVELÁZQUEZ. Thank you. Now I recognize Mr. Braley.

Mr.BRALEY. Thank you, Madam Chairwoman.

Ms. Rickard, you attended law school at American University?

Ms.RICKARD. Correct.

Mr.BRALEY. And did they have the typical law school curriculum where you studied Constitutional law?

Ms.RICKARD. Yes, sir.

Mr.BRALEY. And do you believe in the Constitution?

Ms.RICKARD. Absolutely.

Mr.BRALEY. Do you believe in the Bill of Rights?

Ms.RICKARD. Absolutely.

Mr.BRALEY. Believe in the First Amendment right to free speech?

Ms.RICKARD. Yes, sir.

Mr.BRALEY. Believe in the First Amendment right of freedom of religion?

Ms.RICKARD. Absolutely.

Mr.BRALEY. Believe in the Second Amendment right to bear arms?

Ms.RICKARD. I do. Yes, sir.

Mr.BRALEY. Then, why does the U.S. Chamber have such a problem with standing up for the Seventh Amendment?

Ms.RICKARD. The right to an attorney?

Mr.BRALEY. No. The Seventh Amendment says, "In suits at common law, where the value and controversy shall exceed $20, the right to trial by jury shall be preserved, and no fact tried by a jury shall be otherwise reexamined in any court of the United States." That is in the Bill of Rights, that juries, not legislators, get to determine questions of fact in the courtroom.

And one of the most important issues of fact decided in a civil jury trial is what the appropriate damages are to compensate someone who has been injured due to the fault of another. You would agree with that.

Ms.RICKARD. I don't disagree with that, no.

Mr.BRALEY. So why does the U.S. Chamber spend so much money trying to convince us that we know more about the value of someone's injury or death than the people who elected us to Congress, who go into jury boxes all over this country, under the Seventh Amendment to the Bill of Rights?

Ms.RICKARD. I don't believe that we have done—said anything to the Congress with regard to trying to limit jury trials. I am not sure I am following your question.

Mr.BRALEY. Well, when you promote an agenda that says that it is necessary to put caps on damages that a person who has been injured can receive, you take away the right of the jury to determine what is fair compensation for an injury.

Ms.RICKARD. I don't agree with that.

Mr.BRALEY. Well, this is a client of mine injured by a defective product that was sold by a manufacturer who represented that the product would be good and that their products were still on the road and being used 25 years after they were put in service. This is what her face looked like after that side saddle fuel tank exploded in the pickup she was riding in, and she went through hell, and this is what she looked like the day before the injury occurred.

And I just have a very difficult time when people think that we, in Congress, should be substituting our judgment for what people's pain and suffering in cases like this should be, rather than letting the Constitution do its job and letting people who hear the facts and are there to decide what is fair.

Now, you also indicated you believe that people need to have their day in court, correct?

Ms.RICKARD. Yes. Yes, sir.

Mr.BRALEY. Well, if you erect artificial barriers with a statute of repose, you deny people their day in court, don't you?

Ms.RICKARD. I think you can have rules about when people can be able to go to court. Those have been in effect for many, many years. So, yes, people need to have access to the courts, but you

also have to have reasonable rules with regard to when that access takes place.

Mr.BRALEY. Right. And one of the rules that governs the conduct of every attorney who files a case like this in federal court is Rule 11, which requires them at the time they file the case to certify under oath that the case is well grounded in law and fact and is not being filed for any improper purpose, such as to harass or threaten someone with frivolous litigation. You were aware of that.

Ms.RICKARD. Absolutely. But Rule 11 is not effective, sir. I—

Mr.BRALEY. Well, and why is that?

Ms.RICKARD. —would argue with that.

Mr.BRALEY. Isn't it true that a better way to solve this problem is to put teeth into Rule 11 and give judges the incentive to penalize people who file frivolous lawsuits, since we all agree that is a bad thing?

Ms.RICKARD. We would absolutely support more teeth in Rule 11. We have been on the record last year on legislation, on the Lawsuit Abuse Reduction Act, to put more teeth into Rule 11. I think it is an absolutely great idea, and we would be wholly supportive of it. And I agree with the NFIB it ought to be mandatory.

Mr.BRALEY. Now, Ms. Harned, you indicated that we are in a sue first culture. Do you remember that?

Ms.HARNED. Yes.

Mr.BRALEY. Then, can you explain to me why statistics, in state court filings across this country, demonstrate that there has been a decline in the filing of product liability and personal injury cases when you and other groups continue to talk about the sue happy culture that we have?

Ms.HARNED. Yes, and I can, because Mr. Kelly and I were discussing this before. Our guys don't go to court. They don't go to court. They settle out of court. I think 90 percent of the litigation that small business—or it is more than 90 percent that small business owners get involved in, it is settled out of court.

If they can write a check and get rid of the problem, they are going to do that, because it is good for their bottom line. Going to court is not. They cannot afford the thousands upon thousands of dollars it costs to defend themselves.

Mr.BRALEY. Well, that is completely inconsistent with my experience, which is that most small businesses, when confronted with a request to respond to a potential claim, immediately turn that over to their insurance company because they are required to, and then that is where the follow-up comes from, not from the individual small business.

ChairwomanVELÁZQUEZ. Time has expired.

And now this Committee stands in recess, because we have a series of votes. And as soon as we are finished voting, we will come back to continue this hearing.

[Recess.]

ChairwomanVELÁZQUEZ. The Committee is called back to order. And I recognize Chairman—Ranking Member Chabot.

Mr.CHABOT. I like the former rather than the latter, but that is quite all right.

ChairwomanVELÁZQUEZ. Sorry, but it is going to take a long time for that.

[Laughter.]

At least another year and a half.

But in any event, we, again, appreciate the Chairwoman holding this hearing, and we apologize to the witnesses getting interfered with by votes here for kind of an extended period of time. But we are back.

And, Ms. Rickard, if I could go with you first. You, I believe in your testimony, mentioned about the two new studies that were released today examining the impact of lawsuits on small and mid-sized businesses. And you indicated that one study showed that more than three-quarters of the small business owners in this country are concerned that they might be sued by what they would consider to be an unfair or frivolous lawsuit.

And many have had to raise their prices or even consider reducing hiring additional personnel/workers because of that. And I believe you also indicated that 62 percent say that they could grow their businesses if they felt that they would be protected from lawsuit abuse.

Could you perhaps expound upon that a little bit, why the lawsuit abuse that you have indicated in your testimony, the impact that it really has had on businesses, whether they hire more people, and the effect that it has had?

Ms.RICKARD. When you are dealing in a small business, you have a limited number of resources, a limited number of employees. So if you are slapped with a lawsuit—and, you know, some lawsuits are valid lawsuits. We should all understand that. But there are many where they are frivolous or unfair.

And so it saps resources in time and attention in an entity that doesn't have a lot of resources and needs to be focused solely on growing their business. What happens is they get hit with a lawsuit, and then they have to make certain decisions because, you know, it is difficult to balance the books. Some are insured, but about 20 percent of the costs that we looked at were out of pocket.

So in those circumstances, they do have to make decisions about growth, make decisions about products. Is it worth having a certain product in the market? Is it worth going into a certain area to expand your business? Those types of things are everyday issues that they have to deal with, and so I think the relevance of the study is how it changes—how a lawsuit impacts decision making by someone in a small business, which is a much different thing than with a larger business.

Mr.CHABOT. Thank you.

And, Ms. Harned, if I could go to you next, you are the representative of the National Federation of Independent Business, which tends to be the smaller businesses in this country, is that right?

Ms.HARNED. Correct.

Mr.CHABOT. And in your testimony you indicated that sometimes you have settlements in the, say, $5- to $10,000 range. Now, one might argue that, well, that is the reason that businesses carry insurance, and they ought to be fully protected, so they shouldn't worry about these relatively small lawsuits. But, in fact, as you indicated in your testimony, those can mean a great deal, especially

if you have a number of these things, if you're targeted with these what I would term "frivolous lawsuits" in many cases.

Could you, again, tell us how that does affect a small business, even the relatively small to some businesses or small to some people, how this affects—could affect a business?

Ms.HARNED. Yes, thank you, Congressman Chabot. For the small business, that is time away from their business that they are going to have to take, even if they do have insurance coverage, dealing with the litigation problem. And I would just point up in response to earlier questioning, too, that for small business owners, you know, they are trying to meet payroll every day.

So maybe in actual lawsuit abuse, going back to our survey, is not going to be high on their priority list of things that they are dealing with, but the cost and availability of liability insurance definitely is, and that is because of the claims that are—they are having to file and others are filing because of the lawsuits or the threatened legal action that they are engaged in, which, as we have mentioned before, often results in settlements as opposed to actually the small business owner being able to afford to go to court to set the record straight if you will in those cases where they were improperly targeted.

But, yes, the $5- to $10,000 settlements, it is much like the regulatory cost that small business owners are asked to bear. It is the death of 1,000 cuts. Enough of those are really going to cripple a small business, and, of course, a lawsuit will put them out of business in many instances.

Mr.CHABOT. Thank you.

Madam Chair, am I still okay on the time? Okay.

Mr. Kelly, if I could go to you next. You mentioned the act that a Democratic member, Mr. Boren, and myself have introduced, the Innocent Sellers Act. Would you tell us again how that would be helpful to those that don't actually manufacture a product, so you actually haven't done something, all you have done is essentially sell it in the condition you got it to the ultimate consumer without changing it? What would this do for folks like yourself?

Mr.KELLY. Well, if we didn't manufacture it, alter it, install it, or design it, all we did was sell the product, we didn't do anything wrong. So the hope would be that we would no longer have that liability, that we would have to face these $5- and $10,000 settlements that you spoke about, or face legal battle or litigation. This would relieve us from that.

But if we did do something wrong, we would only be liable for the proportion of what our wrongdoing was. So that is a great help that we are no longer on the hook for 100 percent of the loss on a product that all we did was sell it. We did nothing with manufacturing, designing, or altering, or installing.

Mr.CHABOT. Right. Thank you. In other words, it does away with something that we referred to as joint and several liability. But thank you.

And then, finally, Mr. Freedenberg, or Dr. Freedenberg, has the burdening litigation trend contributed to the decline of the manufacturing sector in your opinion? And does it—is that burgeoning lawsuit, has that affected U.S. companies' ability to effectively compete with foreign manufacturers?

Mr.FREEDENBERG. The answer is yes. If you add it into other regulatory costs, I think there was a recent study by Manufacturers Alliance that shows about a 22 percent extra burden for U.S. manufacturers versus, say, the European competitors. But the other thing it does, which is important and it is important for jobs in the United States, is it affects decisions on where to invest.

That is, if you have a high—this is part of the overall overhead cost, you have that high cost, you decide that you are going to—the next investment you are going to make is perhaps in China or somewhere offshore rather than in the United States, then that is a loss for U.S. workers.

Mr.CHABOT. Thank you. And in the 12-year statute of repose that you referred to in your testimony, which is the bill we are talking about—

Mr.FREEDENBERG. Right.

Mr.CHABOT. —that would also arguably make us more competitive with the Asian countries.

Mr.FREEDENBERG. Yes, it would. It would, both in the United States—well, it would lower costs to us, because it would reduce both insurance and litigation costs, and it would help us vis-a-vis the very strong competition we have coming into the United States, because part of it is the overhang that we have of older machines.

Mr.CHABOT. Thank you. And if I could just conclude, Madam Chair, by just saying that legislation also—the worker, if injured by one of those products, is protected, because there would only be coverage if your—the manufacturer would only be covered if the employee that was injured is covered by worker's compensation. So you would never have—

Mr.FREEDENBERG. Right.

Mr.CHABOT. —a worker that wasn't compensated. And I yield back.

ChairwomanVELÁZQUEZ. Mr. González.

Mr.GONZÁLEZ. Thank you very much, Madam Chairwoman, and I want to express my sincere thanks to the witnesses for your patience and your testimony. I am not sure that I am going to agree with you, but let us have an honest disagreement and let us have an honest debate.

No one is for frivolous lawsuits, and I am sure there have been some studies conducted since what I am about to cite, but let me go over a couple of things, so that—the background for my questions.

This is from a memo, and it says, "Conflicting evidence on tort cases. The United States General Accounting Office, the GAO," which is the gold standard by members of Congress, "did a comprehensive study in 1988 on the extent of product liability litigation growth and concluded that these data seem inconsistent with the contention that there is a rapidly-accelerating growth in federal product liability filings across a wide range of products." That was 1988, and I am sure we have something more recent. I am not sure that the result would be any different.

Let us go to 2006. A 2006 survey by the Federal Judicial Center, the research and education agency of the federal court system, shows more federal judges do not view frivolous lawsuits as a prob-

lem. Seventy percent of the 278 federal court judges who responded to the survey declared that groundless litigation is either a small problem or a very small problem, and 15 percent said it was no problem at all.

That means 85 percent of the federal judges that responded, nearly 300, said that it was a small problem, very small problem, or no problem at all. And I think that is where the reality probably lies.

I also want to look at this as public policy, and we all have our roles—the business community, the legislators, the lawyers, everyone. The bottom line is: how is the public best protected from dangerous products? That should all be our concern, whether you are the individual selling or manufacturing the product or you are the legislators legislating the regulatory scheme.

So you would say, well, government has a responsibility. Why don't you set up a governmental agency or department, and we do. We have the Consumer Product Safety Commission that has jurisdiction over thousands of products, not all of them. Some that you discussed may not come under their umbrella. I am going to tell you about a very interesting hearing that Energy and Commerce just had recently, one of the subcommittees, that I was able to participate—in which I was able to participate.

And this is some of the information that was provided us. The Chicago Tribune summed up what many consumer groups have charged is wrong with our nation's consumer product safety system. "A captive of industry, the Consumer Product Safety Commission lacks the authority and manpower to get dangerous products off the store shelves."

So don't count on government doing it. Don't count on a formal, recognized, regulatory commission or agency of the Federal Government, or the state government, to do it, because they are not going to do it. And this is what we found out—non-rigorous safety standards, that most standards are voluntary, that the manufacturers of these products volunteer to abide by those standards, number one, but they also set the standards. They are voluntary standards.

Limited testing of products, no real live type testing is really going on appreciably. Recall ineffectiveness—I love this—the CPSC has limited power to mount effective recall campaigns. First, because of limitations in the law on the agency's ability to make negative statements about specific products, the agency must negotiate with the manufacturer on the wording of a press release announcing a recall.

Now, you are saying, well, we need to improve on that. Well, I say we do, too. At the beginning of the Reagan administration, the CPSC was cut by a third, from 1,000 employees in 1981 to 600 employees two years later. Where are we today? Four hundred employees.

The President's budget request for the agency for fiscal year 2008 calls for 401 employees. Government is not going to do it, so let us go and shift over the big plan that we have out there to serve society's best interest. What would it be? What would be our second choice?

I would say it is the civil justice system, and that is all that people have. And I think that is why Mr. Braley is a little upset about

some things. And we can trade, one for one, abuses on both sides of the fence. You know that, and the lawyers that are up there know exactly what I am talking about.

Now, we know government is not going to do it, so what do you think of doing with the civil justice system? Why do we have shared liability? This is shared liability, because it promotes shared responsibility that businesses both small and large owe to society in its entirety. The real fear I think that small businesses face and have is being sued by big businesses—big businesses that can hire the Akin Gumps and the Baker Botts of this world, because I saw it every day for 25 years, how this game is played out in the courtroom.

It wasn't products liability. It wasn't tort. It wasn't personal injury, because I think everyone in this room really knows what is going on out there. No one likes to be sued. I never had a client that said, "I deserve to be sued, please." No one believes they should be sued.

So if we think in terms of what we are trying to do here, as I understand, there may be an abuse or two, but we can go over there and try something that wholesale destroys a true system, and I know that you pointed out some abuses. You say, "Why a contingency fee?" Because not everyone out there can afford an hourly fee that an Akin Gump or a Baker Botts charges. It just doesn't work that way. We know that, and I wish we would get away from that.

I feel for the small businessmen, and they are good people, that may have that slide. And kids may be injured, and it may be because of misuse. And they still have to incur the cost of defending.

But who would be the first person to receive notice that a product may be defective or cause an injury or subject to misuse? It is going to be the individual that usually sells it and supervises its use. Unfortunately, that is the small businessman, and we hope that you go back up that chain and get to that manufacturer.

Mr. Kelly, I am going to make an assumption that you know much more about the product that you sell than the consumer, and I think that you owe the consumer some duty and responsibility to know something about the inherent characteristics of that particular product. I know you share that with me.

So if you are talking about a law that would totally relieve you of any responsibility and duty to know more about the product that you are selling, we have got serious problems, and especially with as much product that is being imported. And I know I—

ChairwomanVELÁZQUEZ. Time has expired.

Mr.GONZÁLEZ. Thank you.

Mr.CHABOT. Could I ask unanimous consent that Mr. González be given an additional minute, and ask if he would yield to me for a minute?

Mr.GONZÁLEZ. Now, that is amazing, when someone is asking something in your behalf and then they take it.

[Laughter.]

I will tell you, my colleague, my dear, dear colleague, I will yield in a minute if you don't—and since we are—you have been so patient, and we do need to have this particular discussion, but we have to figure out who is—and I will yield in a particular—in a minute here.

If you want to look at self-regulation, which doesn't work—and human nature being what it is, and we are all human, whether you are a businessman or not out there, do you really believe it was the manufacturer, the distributor of the Pinto automobile that took care of that gas tank? Do you really believe that the tobacco industry that lied for all these years about the inherent characteristics of their product would have turned themselves in?

As a matter of fact, most of these individuals new about the inherent dangers of the product, kept them secret, and even lied in legal proceedings. We can go into lawnmowers, we can go into kitchen ranges, we can go into baby cribs. How about fire retardant materials? When I started my practice, we had Boy Scouts that burned in tents, and it was the legal profession that set those standards.

We had infants who were terribly disfigured because there weren't any fire retardant standards. Did the manufacturers know that danger? Did the distributor and seller? Of course they did. No one moved forward. It was the civil justice system, and it does have an appropriate role. And I could go on and on.

ChairwomanVELÁZQUEZ. Is the gentleman going to yield?

Mr.GONZÁLEZ. I am going to yield to my dear friend Mr. Chabot.

Mr.CHABOT. I will tell you what, Madam Chair, what I will do is, if he would like to yield back, I will just take our side—I will only take—I am not going to take five minutes, but I am—

ChairwomanVELÁZQUEZ. Go ahead.

Mr.CHABOT. —being recognized on my own time. Thank you.

I will never try that again, Charlie. That didn't work so well.

[Laughter.]

That is quite all right. You were on a roll there.

Just a comment. I don't want to comment on everything that the gentleman from Texas said, but he did talk about a survey done by federal judges saying that they didn't consider these types of lawsuits to be a problem. I would just note a couple of things.

Number one, they are not the ones being sued. You know, it is the small business folks that are being sued. And their employees, as we have said, their very jobs are at risk, and growing the businesses and hiring more and more people.

And, secondly, the number one thing that is probably on their list is they want more pay. As you know, we have both been up here a while, Charlie, I mean, that is the main thing that they seem to be concerned about. You know, they don't think they are being paid high enough.

And, thirdly, the judges, all of them at the federal level, were all lawyers before they became judges, many of those trial lawyers. And, finally, I would just note that most of the lawsuits are actually not in the federal courts, they are of courts and the state courts, and there may well be surveys of the state court judges that say similar things. I am not aware of that one way or the other, but I wouldn't necessarily put a whole lot of stock in what the federal judges are saying in this respect.

And I yield back the balance of my time.

ChairwomanVELÁZQUEZ. I recognize Mr. Johnson.

Mr.JOHNSON. Thank you, Mr. Chabot. Yes, judges certainly do deserve a higher rate of pay. But I think that most judges try to be conscientious about the pronouncements that they make, and most judges—many judges were trial lawyers, but it seems to me most of them were either prosecutors or civil defense lawyers from large firms before they became judges. Most judges are not plaintiff's lawyers, and they were not public defenders or criminal defense lawyers.

But before I proceed on, I must disclose the fact that I have practiced law for 27 years, primarily criminal defense, but I did do a fair amount of plaintiff's injury litigation and some business tort litigation as well. And so I do have an abundant respect for my brethren and sistern who practice law and represent injured people, and also people who have been accused of crime.

And I believe in the jury system of this country. I believe in judicial discretion. And I also believe firmly that big-pocket defendants will do everything that they can do to immunize themselves from people who would complain about their actions which led to the aggrieved person being injured.

So that having been said, I want to ask some questions. Ms. Harned, you previously practiced law at Olsson, Frank and Weeda, P.C.

Ms.HARNED. Correct, yes.

Mr.JOHNSON. Was that a defense firm or a plaintiff's firm?

Ms.HARNED. We did mostly regulatory work and worked—helped clients navigate through Food and Drug Administration and USDA and some lobbying as well.

Mr.JOHNSON. Pretty much large corporate interests that you represented, is that correct?

Ms.HARNED. We had several big clients, but I have to say I personally worked a lot with some really small clients like I do now that, you know, have, you know, 25 people or less, some even five or less employees.

Mr.JOHNSON. And you stated—was it you that stated that 69 percent of small businesses consulted an attorney during the last year?

Ms.HARNED. Yes, that was according to a use of lawyers poll that we put out, the NFIB Research Foundation put out in 2005, at the end of 2005.

Mr.JOHNSON. And that wasn't just for purposes of defending against lawsuits or potential lawsuits, was it?

Ms.HARNED. That is correct, but I will say—

Mr.JOHNSON. That included consultations for business-related matters and that kind of thing. So you don't mean to lead us astray with respect to the 69 percent of small business owners consulting an attorney about defending themselves from a litigation claim.

Ms.HARNED. No, and thank you for that. But it does show how much our culture has changed, that this has become integral for small businesses.

Mr.JOHNSON. And, of course, we are not here to talk about putting limits on the amount that an hourly firm, a firm charging an hourly fee, could put on attorney's fees that they charge to small businesses. We are not here for that purpose. We—

Ms.HARNED. Well, and we wouldn't advocate that either, I don't think.

Mr.JOHNSON. And certainly no one would want to keep a large corporate law firm from charging, you know, $400 or $500 an hour, but you do see some legitimacy in the claim that we should limit contingent fees to plaintiff's lawyers. Is that correct?

Ms.HARNED. Correct, yes.

Mr.JOHNSON. You would limit a person's ability to hire an attorney on a contingent fee basis.

Ms.HARNED. Oh, no. I am sorry. I misunderstood you. I do not have—as far as I know, NFIB does not have a position on contingency fees at the federal level.

Mr.JOHNSON. Well, I would let you know that lawyers who represent injured people generally work on a contingent fee basis, and to take a third of a $5,000 settlement or a $10,000 settlement, there is really no money in that for the average lawyer. It has been my experience that most lawyers take cases that would result in a higher basis from which they could recover a contingent fee. So I am going to—for some reason, I just don't trust your assertion that $5- and $10,000 settlements are killing—are just killing small businesses.

But, Ms. Rickard, you talked about frivolous and unfair lawsuits. And I don't know what you mean by unfair. Maybe unfair means by the mere fact that someone would have the gaul to bring a lawsuit against a large corporate interest for a product liability or any other claim. And it seems to me that you have been more—you are fighting more for overall limits on people being able to bring lawsuits as opposed to just statute of repose on tort—excuse me, on product liability issues, just from listening to you today.

But you worked as a Vice President for the Dow Chemical Corporation, and you all have been the targets of a number of class action litigations throughout the years. Is that correct?

Ms.RICKARD. During my time there, yes, they—

Mr.JOHNSON. And these had to do with—

Ms.RICKARD. —mass actions and—

Mr.JOHNSON. Yes, but they had to do—

Ms.RICKARD. —more mass actions than class actions.

Mr.JOHNSON. Do you see that there is any social utility in the ability of those kinds of lawsuits to go forward? Do they have a positive impact on public policy, in your opinion?

Ms.RICKARD. There absolutely is a benefit to having class action and mass action capabilities. The issues really become—and, again, this hearing is about small business. But if you want to talk about larger business, I am happy to do that.

Mr.JOHNSON. Well, yes, and the reason why I talk about the larger business, because it seems like they are parading around or parading behind the issue of small business. But, really, these changes in the law that you are suggesting and advocating for would actually help the larger businesses as well.

Ms.RICKARD. The issue here is across the board, issues pertaining to lawsuit abuse across the board, whether you are a large business or a small business.

Mr.JOHNSON. Well, tell me—

Ms.RICKARD. At the U.S. Chamber, 95 percent of our membership are small businesses.

Mr.JOHNSON. Well, you talk about lawsuit abuse. Do you think it is an abuse for a person who has been injured to be able to find a lawyer who is willing to take a case because they think they can make some money out of it, because it is a legitimate case? Do you think it is wrong for that person to be able to bring a case to court?

Ms.RICKARD. Absolutely not. But I do think—

Mr.JOHNSON. Well, how do you determine whether or not a case is—

Ms.RICKARD. I believe—

Mr.JOHNSON. How do you determine whether or not a case is actually frivolous or not?

Ms.RICKARD. Well, if you look—the people I brought to this hearing—

Mr.JOHNSON. Can you do that?

Ms.RICKARD. —today—yes, Chris Moser, who has an Internet company with two employees, got socked—he got brought into an $800 million lawsuit on the basis of—

Mr.JOHNSON. And an $800 million lawsuit is a frivolous litigation claim?

Ms.RICKARD. Yes. When the person bringing the claim is trying to collect on gold bonds against banks during—you know, to collect money from these banks.

Mr.JOHNSON. Well, now, ma'am, you have been an attorney for how long?

Ms.RICKARD. Over 25 years.

Mr.JOHNSON. And you think an attorney would get involved in an $800 million lawsuit that is frivolous?

Ms.RICKARD. Absolutely.

Mr.JOHNSON. And spend—

Ms.RICKARD. We see it every day, sir.

ChairwomanVELÁZQUEZ. Time has expired.

Ms.RICKARD. Every day.

Mr.JOHNSON. I am going to disagree with you on that.

ChairwomanVELÁZQUEZ. I now recognize Mr. Westmoreland.

Mr.WESTMORELAND. Thank you, Madam Chairman.

Let me help Ms. Rickard a little bit, not that she needs my help, but unfounded, unnecessary lawsuits—you know, could that be considered if somebody like this Internet company was actually a fourth or fifth party to whatever the problem was? Does it come into throwing a large net out just to see whoever they can catch and let everything kind of filter through that net? And are these lawsuits that would include people that don't even know the parties involved in it?

Ms.RICKARD. Yes. There are—in this instance, in this Internet case, they did not know the parties. They were hosting a site for discussion about banking issues, and gets pulled in, probably for venue purposes, into litigation and has to spend time and attention away from that, hire a lawyer, have legal fees.

You know, the problem here is we get—I think we need to all acknowledge there are valid lawsuits, and there are frivolous and unfair lawsuits. And you have to have a system that weeds out the

frivolous claims and discourages attorneys from filing them merely to collect legal fees. And there has to be a distinction there that we all need to acknowledge.

This isn't one side or the other is completely right here. We certainly are not espousing that people who are injured should not have access to the court system. They most certainly should.

Mr.WESTMORELAND. Well, I am glad Mr. Braley is coming back into the room, the learned trial attorney he is, and he certainly did a great job questioning the panel.

But, you know, it is interesting that he brought the pictures of this young lady, but he didn't bring his billing sheet where he may have gotten as much as 30 or 40 percent, but this unfortunate lady—and nobody wants any of us to go through the unfortunate situation that this lady went through, and it is very unfortunate what she did go through, but I don't think anybody meant for her to go through that. I don't think this was done on purpose by anybody that would cause her or her family to go through this tragedy that it did.

But, you know, if attorneys want to make this thing fair, then what we need to do is go to a loser pay situation. That way, if the case is reversed, and that defendant wins, then the plaintiff needs to pay all of those legal expenses, because this is kind of a win-win for these attorneys, because, you know, they have got defense attorneys and plaintiff's attorneys, and so, you know, they are all getting part of the action whether they win or lose.

The trial attorneys probably try a little bit harder, because theirs is based on people's unfortunate situations, and a lot of times they, you know, wheel them into the courtroom or bring them in these tragic situations that they are in to get the jury to see them, and to understand the tragedy that they have gone through, and then, you know, who is to say the insurance company probably doesn't have a face there, or whoever this defendant is.

So I understand what you are saying on the contingencies. And my other colleague, Mr. Johnson, talked about these $5- and $10,000 settlements. That is basically just blood money, just something not to have to go to court. You know, at some point in time, you have to make a business decision. And when your attorney tells you it is going to cost $20,000 to go to court, or you can pay them off for $10,000, that is easy money for some of these attorneys. He talked like they wouldn't get involved for that. I think they would get involved for $1.99, if you want to know the truth.

So I have made more of a statement than I have anything else, but I would like to ask each and every one of you a question. Ms. Rickard, you are not trying to limit anybody's ability to go to court for any legitimate reason, are you?

Ms.RICKARD. No, we are not trying to limit anybody's ability to go to court for any reason. People who are injured or aggrieved should be able to have full access to court and to a jury trial.

Mr.WESTMORELAND. And, Ms. Harned, you are not trying to keep anybody from having a legitimate reason to go to court and to have their cause heard, are you?

Ms.HARNED. Absolutely not.

Mr.WESTMORELAND. And, Mr. Kelly, you are not saying that you don't want anybody to go to court that has a legitimate complaint, do you?

Ms.HARNED. No, sir.

Mr.WESTMORELAND. And Dr. Freedenberg?

Mr.FREEDENBERG. No.

Mr.WESTMORELAND. Thank you, Madam Chair.

ChairwomanVELÁZQUEZ. Time has expired.

Is there any other member who wishes to make questions? Mr. Braley?

Mr.BRALEY. Thank you, Madam Chairwoman. I would certainly like the opportunity to correct the state of the record on the case that I identified. This case was against what at the time was the largest corporation in the world, and I can assure you that they had an army of attorneys who have been defending these cases for a long time.

I represented a woman from Benton County, Iowa, who didn't have anybody to speak up for her. I took that case on a contingency fee basis, which meant if I didn't get a recovery for her, I wouldn't get paid a dime. I worked for three and a half years on this case, and it wasn't until I knew that I had a legitimate claim after extensive research that I even contacted the manufacturer to talk about the merits of the case.

Mr. Freedenberg, I wanted to ask you a question about the disclosure in your written statement, because I think it points out one of the problems that nobody is talking about, that from the standpoint of consumers there is a huge issue. You noted that the association you represent had received $225,000 from the Commerce Department's Market Cooperator Development Program for a technical center in China. Is that correct?

Mr.FREEDENBERG. That is correct.

Mr.BRALEY. One of the main problems that we see in a lot of these products cases is that, as our trade imbalance with China skyrockets, and more and more Chinese products flood U.S. markets, the sellers of those products who provide them to consumers, then are the only direct person with a business located in the United States when these claims arise.

I have pursued claims against Chinese manufacturers. And if you are dealing with getting jurisdiction over a Chinese manufacturer in Communist China, it is a long and arduous process to even bring them to the table. And then, if you are successful in getting a judgment, it is just a piece of paper that means nothing, because you still, then, have to levy on that judgment in a foreign country with many obstacles built in.

So my question for you is: given this trade imbalance, and given the fact that many of the small businesses are selling products manufactured in China, what remedy is there if we want to try to figure out how to pass on the burden of that risk to the responsible party, the Chinese manufacturer, who puts that defective, unreasonably dangerous product, into the stream of commerce in the United States? How are we going to hold those Chinese corporations responsible when something like this happens?

Mr.FREEDENBERG. Well, just to be clear, we were—we are selling a product for manufacturers in China, not to sell back—we are not selling a finished product in China. But, anyway, the main thing is, having been a trade official, you need to negotiate good trade agreements with provisions in them that allow for access to Chinese manufacturers.

You need to negotiate what we are doing when we have trade agreements, if they are signed correctly, is that you get some access to them, you get some ability to go after them at the appropriate time.

Mr.BRALEY. Have you ever had any experience trying to do that in practical terms?

Mr.FREEDENBERG. Well, in practical terms, we have great difficulty, and I recognize we are having difficulty right now getting the Chinese to live up to the agreements they make. But that doesn't mean—that really calls for a better set of—better next round of negotiations on the national level, so that—or the international level, so that you can have the individual capability to go after them. It is, I agree, very much difficult to go after that.

Mr.BRALEY. You also made the statement that several AMT members have been forced to close their doors because of product liability lawsuits. Do you remember that?

Mr.FREEDENBERG. Yes.

Mr.BRALEY. Who are they?

Mr.FREEDENBERG. Well, I cited one in my testimony, which is Madison. I could get you for the record—I didn't bring along the list with me, but I can get you for the record others who have been forced to close their doors for—because of the lawsuits.

Mr.BRALEY. Could you agree to provide those names to the Committee?

Mr.FREEDENBERG. I would be happy to.

Mr.BRALEY. And the dates when they went out of business?

Mr.FREEDENBERG. Definitely.

Mr.BRALEY. And you mentioned this Madison verdict of $7.5 million that led to a bankruptcy filing.

Mr.FREEDENBERG. Right.

Mr.BRALEY. Do you know whether the judgment that was entered in that case was ever paid?

Mr.FREEDENBERG. I don't have the information right now, but I—

Mr.BRALEY. Do you know whether the company filed a Chapter 7 or a Chapter 13 bankruptcy?

Mr.FREEDENBERG. No, I don't know.

Mr.BRALEY. And that would be a big difference, wouldn't it, into whether that claim was ever paid? Because if it was a Chapter 7 liquidation, in all likelihood it would mean that the person who had that judgment would get very little, if anything.

Mr.FREEDENBERG. Right.

Mr.BRALEY. Mr. Kelly, I wanted to follow up on your presentation, because one of the things that I do have experience with is working with people in your industry who buy machines manufactured overseas and then have problems in the workplace that injure their workers and add to their worker's compensation liability.

Specifically, I worked with a company called Birch Manufacturing in Waterloo, Iowa, which has a huge business that processes

wood products into cabinetry for use in bathrooms and kitchens. And they had purchased a double-edged sander manufactured by an Italian corporation, put it in place in their factory, and the very first day that it was started up a drawer that was being sent through the sander shot through, knocked one employee unconscious, ricocheted off and hit another employee, and fractured the orbit of his eye.

It was later determined that the product had been defectively designed, which the company in Italy acknowledged, but there was another huge problem of getting jurisdiction over a foreign manufacturer, and, in fact, worked closely with Birch Cabinet because they knew if the manufacturer ultimately held responsible then they would get back money that they had paid for worker's compensation benefits as an offset.

Have you heard from any of your members about that type of dynamic and their need to be able to hold manufacturers of defective products accountable?

Mr.KELLY. No, not to my recollection, but I don't remember any of those type of situations. Now, we will research that and be happy to get back to the Committee with some written examples, if we have some, where this has been true.

Mr.BRALEY. Do you know, as a general proposition, whether people who are part of your association use machines in their businesses that are manufactured overseas?

Mr.KELLY. Not normally. Our business—most of our members are lumber dealers, so we are buying already manufactured products that we aren't manufacturing ourselves. So we don't do any manufacturing unless we do run truss plants, and those type of things, and those people would be using some of those machines, or if they do run door assembly plants they may have some of those.

Mr.BRALEY. So you are more involved in the chain of distribution of finished products.

Mr.KELLY. Exactly.

Mr.BRALEY. All right. Thank you very much for your time.

And thank you, Madam Chairman, and Ranking Member Chabot.

ChairwomanVELÁZQUEZ. Thank you. Do you wish to make-

Mr.WESTMORELAND. Can I ask a few follow-up questions?

ChairwomanVELÁZQUEZ. Sure.

Mr.WESTMORELAND. This question to anybody on the panel—does anybody consider General Motors a small business? Ms. Rickard?

Ms.RICKARD. Do I consider General Motors a small business? No, but they give a lot of business to small—to—

Mr.WESTMORELAND. But they are not a small business.

Ms.RICKARD. No, absolutely not.

Mr.WESTMORELAND. Does anybody on the panel think that our small business manufacturers should be used as fodder for trade agreements? These are two different areas that need to be addressed. And I agree with the gentlemen—we need to make sure that in our trade agreements we have a way to get to those foreign companies that make these defective things. But I think it stretches a little bit too far that we are going to use our small businessmen to get to these foreign countries.

Thank you, ma'am. That is all I have. I yield back.

ChairwomanVELÁZQUEZ. Mr. Chabot, do you have any other questions?

Mr.CHABOT. I don't. I would just like, again, to thank the witnesses for their testimony, and thank the Chairwoman for holding this hearing.

ChairwomanVELÁZQUEZ. I ask unanimous consent that members have five days to enter statements and supporting materials into the record.

And this hearing is adjourned.

[Whereupon, at 1:41 p.m., the Committee was adjourned.]

STATEMENT
Of
the Honorable Nydia M. Velazquez, Chairwoman
House Committee on Small Business
Hearing on Liability Reform and Small Business
May 17, 2007

I call this hearing to order in the issue of "Liability Reform and Small Business."

I would like to thank Ranking Member Chabot for bringing this issue to the committee and arranging for the witnesses to testify. The issue of civil liability is clearly something that impacts small businesses in a variety of ways.

I think we can all agree that frivolous lawsuits harm small businesses and our economy. No one will ever defend that practice. However, in order to have a discussion about liability reform, we must consider whether changes in federal law could have an impact on legitimate rights of action, in addition to stopping frivolous suits.

For today's hearing, the issue of liability reform must be considered in light of the many roles that small businesses play. Not only are they are manufacturers, but small firms are oftentimes the consumers and sellers of products.

Our legal system must ensure that the rights of entrepreneurs are protected—both as the plaintiffs or defendants in lawsuits. The economy depends on the ability of companies to protect their contractual rights, including their relationships and transactions with other businesses.

I do understand, however, that we will hear about how our current legal system has its shortcomings. If our tort system is not used properly it can and does impose costs on businesses—many times unfairly. Determining the extent of these costs is difficult and figures are often disputed.

My hope is that we can open up the debate today beyond litigation costs and examine the different factors that may be driving up overall liability insurance premiums. According to a study by the National Federation of Independent Business, small business owners rank liability insurance as one of their top concerns. Law suit abuse is near the bottom of that list.

These findings suggest there are a number of factors contributing to liability costs—including insurance company practices. As such, I believe that any approach to addressing liability issues must be multi-pronged and go beyond simply limiting the ability to sue.

The states that have successfully handled overall insurance costs have enacted both tort reform AND insurance reform. A number of years ago, California addressed soaring insurance costs by passing Proposition 103.

Proposition 103 required that insurance companies rollback rates and file an application with the insurance commissioner to increase rates. Companies were also required to hold public forums before raising premiums. Studies showed that this was a primary driver in reducing insurance costs in the state.

A similar approach is needed to help small businesses with rising liability insurance costs. To truly get at the major problems behind these prices, there must be greater transparency in insurance markets. While I know many of the witnesses have focused their testimony on litigation, I would be interested in hearing about their experience with insurance companies when it comes to overall liability coverage.

While not always perfect, our nation's justice system is the best in the world. There is room for improvement, but we need to keep in mind that lawsuits can serve to protect honest small business owners who are doing the right thing.

A working legal system will ensure that the products that companies manufacture are safe, yet affordable to produce. A functioning system fosters competition in terms of safety by rewarding companies for manufacturing safe products while penalizing those who cut corners.

I look forward to today's testimony and thank the witnesses for their participation.

Opening Statement	
Hearing Name	Liability Reform and Small Business
Committee	Full Committee
Date	5/17/2007

Opening Statement of Ranking Member Chabot

"I want to thank Chairwoman Velazquez for holding this important hearing in which we'll look at how the tort system is impacting our nation's small businesses. We'll also review some liability reform measures that would allow small business owners to focus their energies on growing their businesses and creating jobs rather than worrying about fighting frivolous lawsuits.

"I also want to thank our panel of witnesses for being here today. It's a very accomplished panel of experts who have been dealing with this issue for a long time. I'm sure everyone up here will benefit from your testimony today. Thanks again for coming.

"Small businesses are the backbone of our nation's economy. Yet small businesses are bearing the brunt of the increasingly litigious nature of our nation. Small businesses pay 69 percent of all business tort liability costs (that comes to about $100 billion annually) but take in only 19 percent of all business revenues. Think about that. Small businesses are responsible for less than one-fifth of business revenues but pay more than two-thirds of the liability costs. That's unfair. It's not good for the economy. And it's not good for consumers either who have to pay more for good and services as a result of frivolous litigation. Our nation's small business owners need Congress to pass common sense liability reform legislation.

"Mr. Boren of Oklahoma and I have introduced the "Innocent Sellers Act." The Innocent Sellers Act would simply change the law so that sellers do not take on liability for a product merely by selling that product. If sellers are negligent with respect to certain specific non-sale activities they would be responsible for the harm that their negligence causes, and nothing more.

"Another area of product liability reform where small businesses need some relief is in the area of durable goods manufacturing. Unfortunately, previous Congresses have failed to deliver a much-needed product liability reform bill. During the last few sessions of Congress, I've introduced legislation – the Workplace Goods Job Growth and Competitiveness Act – that would benefit small businesses, consumers, and workers by creating a nationwide twelve-year "statute of repose" for durable goods. This would simply recognize that durable goods that have performed capably in the workplace for 12 years or more, work. After that point in time, the manufacturer should not be held liable for an obsolete or modified machine tool. It's an issue of fairness. And it's an issue of commonsense.

"Next week I plan to reintroduce the "Small Business Liability Reform Act" that NFIB, among others, has worked so diligently on. This bill would strengthen the evidentiary

standard on claims made against small businesses, providing some much-needed reform to our nation's tort laws.

"Common sense liability reform is important for small businesses that make and sell products as well as the consumer who ends up paying higher prices as a result of frivolous lawsuits.

"I want to again thank our panel of witnesses and look forward their testimony.

Thank you again, Madam Chairwoman, for holding this important hearing. And I yield back."

Statement of Rep. Jason Altmire
Committee on Small Business
"Liability Reform and Small Business"
May 17, 2007

Thank you, Madam Chairwoman. Liability costs are a concern for American entrepreneurs, and I look forward to hearing from the esteemed witnesses on the issue.

There is no question that there are unscrupulous individuals who have looked to profit from small businesses by filing frivolous or unnecessary lawsuits. Many small businesses have felt the sting of a lawsuit that they did nothing to deserve. At the same time, it is clear that the vast majority of lawsuits are filed for genuine reasons and to address legitimate harms. It is also important to remember that small businesses are not just defendants—they are frequently plaintiffs who require a fair and accessible legal system to protect them in the event of damages suffered or a dispute that cannot be resolved. I look forward to an evenhanded discussion on the issue of liability reform today.

Again, thank you, Chairwoman Velazquez, for holding this hearing today. I yield back the balance of my time.

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Statement of Congressman Bruce L. Braley
Hearing on "Liability 'Reform' and Small Business" - May 17, 2007

Madam Speaker, for over 20 years, powerful special interests have attempted to restrict or rescind the Constitutional rights of workers and consumers injured by unreasonably dangerous and defective products, often through well-financed campaigns of half-truths and misinformation.

Today's hearing is just another sad example of attempts to trample the Constitutional rights of American citizens under the guise of shifting the human costs for these dangerous and defective products from the insurers of the sellers to the injured or deceased consumer and the taxpayers of this country.

It should come as no surprise to anyone in this room that the driving force behind this assault on our Constitutional rights is a coalition made up of the most powerful business lobbying groups in this country. A quick review of the top corporate spenders on lobbying from 1998-2006 is a veritable "Who's Who" of corporate tort deform advocates:

U.S. Chamber of Commerce:	$317 million
American Medical Association	$156 million
Pharmaceutical Research & Manufacturers of America	$104 million
Phillip Morris	$ 75 million

At the head of the list ... high above the rest of the crowd ... stands the U.S. Chamber of Commerce. According to recent reports, the U.S. Chamber spent 83% more on lobbying in 2006 than in 2005, spending a whopping $72.7 million on federal lobbying, up from $39.8 million in 2005. In comparison, the overall spending on lobbying activities increased only by 1.7% in 2006.

This startling disparity should cause this Committee serious concern, particularly when that advocacy is part of a long and persistent effort to deprive consumers who have suffered catastrophic injuries or death from recovering fair compensation. According to a National Journal article published on it's website, over the past eight years, the U.S. Chamber's Legal Institute has spent over $101.5 million on federal lobbying for so-called "tort reform."

Madame Chairwoman, it is time to look below the surface of the hype and hyperbole and focus on facts. Here are some important "facts" to consider during today's hearing:

Fact: Statutes of repose do NOTHING to reduce or eliminate frivolous lawsuits. A frivolous lawsuit is, by definition, a case without any merit. Statutes of repose put up an artificial barrier to cases WITH merit by cutting off claims arising from the sale of defective products that were unreasonably dangerous AT THE TIME THEY WERE MANUFACTURED.

Fact: Many manufacturers and sellers of products represent to consumers that their products are intended to last for many years, including years beyond the cutoff date for legitimate claims contained in a statute of repose.

Fact: Caps on damages do NOTHING to reduce or eliminate frivolous lawsuits. In fact, caps only punish those individuals with catastrophic injuries and death claims, by depriving them of the full compensation they should be entitled to under the law. The net result of caps is to shift the burden of the injury from the responsible party to the injured or deceased consumer and their family and to U.S. taxpayers, who frequently end up providing lifetime medical and disability benefits when the wrongdoer is not held accountable for the damages.

Fact: The best way to protect sellers of defective and unreasonably dangerous products is to provide clear rights of indemnification from the manufacturers of the defective products; clear and efficient means of holding foreign manufacturers of defective products accountable for the harm they cause; and to make sure that consumers receive adequate warnings about the risks of using the product and the intended useful life of the product.

The truth is that product liability laws have been making America safer for over 100 years, and making sure that parties responsible for introducing defective products that are unreasonably dangerous into the stream of commerce are held responsible to the people who are seriously injured or killed by those defective products. That is a good thing that promotes responsibility and prevents cost-shifting to U.S. taxpayers, who always get stuck with the tab when the responsible party escapes liability for the full extent of the damages caused.

One final word about so-called "tort reform," Madam Chairwoman. One hundred years ago, when defective products were maiming and killing workers and consumers on a daily basis as part of the industrial revolution, we used the word "reform" to reflect changes expanded protection of individual rights and encouraged greater responsibility on the part of the wrongdoer. It is a said comment on our times that today, the word "reform" is associated with a well-financed movement to strip away Constitutional rights and immunize corporate wrongdoers who place unreasonably dangerous and defective products into the stream of commerce.

Statement of the U.S. Chamber of Commerce

ON: THE IMPACT OF A BROKEN LAWSUIT SYSTEM ON AMERICA'S SMALL BUSINESSES

TO: HOUSE COMMITTEE ON SMALL BUSINESS

DATE: MAY 17, 2007

BY: LISA A. RICKARD

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business - manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 105 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

STATEMENT ON
THE IMPACT OF A BROKEN LAWSUIT SYSTEM
ON AMERICA'S SMALL BUSINESSES

SUBMITTED
TO
THE COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES
BY
LISA RICKARD, PRESIDENT
U.S. CHAMBER INSTITUTE FOR LEGAL REFORM
MAY 17, 2007

Good morning. I am Lisa Rickard, president of the U.S. Chamber Institute for Legal Reform. The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and professional organizations of every size, in every business sector, and in every region of the country. The U.S. Chamber of Commerce founded the Institute for Legal Reform (ILR) in 1998 with the mission of making America's legal system simpler, fairer and faster for everyone.

On behalf of the Chamber and ILR, I appreciate the opportunity to testify before the Committee on the effect of lawsuit abuse on small business. I would request that a copy of my full testimony and the attached studies be included for the record.

America's broken lawsuit system is raising prices for hard-working Americans, crippling companies, eliminating jobs, and clogging our courts with frivolous lawsuits.

Unfortunately, our efforts to improve the legal system are met with stiff opposition by those who seek personal financial gain from maintaining the status quo. Many who resist reform say the crisis in lawsuits against small business is a concoction of legal reform advocates. Don't believe them. Some of them will tell you that legal reform efforts would actually hurt small business owners. Nothing could be further from the truth.

In fact, ILR released two new studies today examining the impact of lawsuits on small and mid-sized businesses. One study shows that more than three-quarters of the small business owners in this country are concerned they might be sued in a frivolous or unfair lawsuit, and many have raised their prices or reduced their hiring as a result.

We asked the nonpartisan market research firm of Harris Interactive to conduct a statistically valid sample of the owners of small and mid-sized business—defined as those with less than $10 million in annual revenues—to determine how the lawsuit system affects their business decision-making.

The results are quite startling.

Nearly half of our qualified respondents have been threatened with a lawsuit, and more than a third of them actually had a suit filed against them sometime in the last ten years. In addition to the time and expense involved, six in ten of these businesses owners say the lawsuit culture makes them feel more constrained in making business decisions generally, and more than half (54%) say lawsuits or the threat of lawsuits forced them to make decisions they otherwise would not have made.

Among those business owners who are very or somewhat concerned about getting sued, 62 percent say they could grow their businesses if they felt like they would be protected from lawsuit abuse. These business owners would largely reinvest the additional revenues in improving their facilities or buying new equipment (80%), increasing wages (76%) and benefits (65%) for their current employees, or by hiring new employees (63%).

The other study we released today shows no sector of the economy is hit harder by lawsuit abuse than America's small business owners. In December, the actuarial firm Tillinghast Towers-Perrin released its annual

report showing that in 2005 the tort litigation system cost our economy some $261 billion.

We wanted to go a step further—to find out exactly how the tort system is threatening American small businesses, which create the bulk of the new jobs in this country. To do so, we contracted with NERA Economic Consulting to analyze the numbers—and what we found was again quite troubling.

The total cost of the tort system to all U.S. businesses, both large and small was an astounding $143 billion in 2005. NERA's study found that small businesses with $10 million or less in annual revenue bear 69% of that cost, paying $98 billion a year.

For a small business with $10 million in annual revenue, that translates into about $200,000 a year that it will pay out in tort-related costs—money that could be used to expand operations, develop new products, or hire additional employees.

Very small businesses—those with less than $1 million in annual revenues—pay $31 billion of the $98 billion per year. What's even more

astonishing is that these very small businesses pay a significant share of their liability costs out-of-pocket—not through insurance coverage—draining assets critical to their continued survival and growth.

I've shared with you a lot of facts and figures, but what does it all mean? It means America's small businesses are paying a high price for our broken lawsuit system in the form of lost opportunities to expand their businesses.

It also means that billions of dollars in small business capital are being diverted to the bank accounts of trial lawyers – rather than being invested in tens of thousands of new American jobs.

And it means that American consumers are forced to pay more for everything they purchase because businesses are forced to raise prices to stay afloat. According to Tillinghast, an American family of four is paying $3,520 each year because of our tort system—that's $880 for every man, woman and child in America. I am certain that America's working families could find better uses for their money.

Real people and real businesses are suffering under the burden of our current lawsuit-happy culture. Some of those real people are here today.

Dennis Herrington joins us from Springfield, Illinois, where he owns and operates a giant slide enjoyed by kids of all ages at fairs throughout the southern part of the state. He has been subject to several lawsuits resulting from injuries allegedly sustained by individuals riding the slide. Not only has his liability insurance increased as a result, he had to purchase video surveillance equipment to monitor the ride and riders for future legal cases, as well as digging into his pocket for the costs of obtaining an attorney to fight the suits. As a result, he has had to increase the cost to ride the slide.

Also joining us today from Los Angeles is Chris Moser, owner of Network 54, a small, Los Angeles-based Internet startup firm with 2 employees. The company hosts online communities, including bulletin boards, chats, forums, and user groups. The company is among the Internet start-ups good enough to survive dot com crash; it almost didn't survive a frivolous lawsuit.

In 2005, Network 54, together with Deutschebank, Commerzbank, and John Hancock Insurance, was sued in federal district court in Florida for $800 million for allegedly defaming Ronnie Fulwood, a former strawberry farmer who now makes his living trying to collect on World War I-era German gold bonds.

Fulwood's allegation was that Network 54 and the German banks, by causing certain statements about him to be posted on a Network 54-hosted banking forum, were conspiring to prevent him from collecting on his bonds. Incidentally, Fulwood's lawyer had earlier earned a reputation for launching creative lawsuits, such as one against the U.S. National Oceanic and Atmospheric Administration for failure to predict the 2004 Indian Ocean tsunami.

Network 54 was eventually dropped from the case and the underlying claim was ultimately dismissed for what the judge called the plaintiff's failure to allege a single fact connecting the defendants to the alleged defamatory statements. Though the outcome of the case was favorable, this wholly frivolous lawsuit cost Network 54 $15,000 in defense costs, not to mention the time and attention it took away from operating the business.

Finally, you may have heard about the administrative law judge here in Washington, D.C. who is suing a small dry cleaning business for $65 million because they lost a pair of suit pants. The story was on the news in Paris, France when I was there earlier this month talking with business owners

about the trial bars' efforts to export American-style litigation features to Europe. Frankly, the Europeans were incredulous.

Unfortunately these stories are not isolated incidences. Similar stories could be told by tens of thousands of small business owners who are victimized by lawsuit abuse each year.

The simple fact is this: our broken lawsuit system is a serious problem for America's small businesses, costing jobs and dampening the spirit of entrepreneurship and innovation at the very core of America's greatness.

ILR's studies highlight why we need comprehensive legal reforms at the federal and state levels that will rein-in the excessive influence of unscrupulous trial lawyers and restore fairness and balance to our legal system.

ILR strongly urges Congress to enact bills that cut back on frivolous litigation. For example, ILR supports legislation which would place reasonable limits on the amount of punitive damages awarded to plaintiffs in liability cases against small businesses, and protect innocent product-

sellers from liability when the manufacturer is directly responsible for the harm.

We also urge you to resist proposals that serve to expand the liability of small businesses: proposals to criminalize product liability; restrictions on alternative dispute resolution mechanisms such as arbitration and mediation; and implied causes of private action masquerading as consumer protection.

In closing, I would like to make clear that ILR and the U.S. Chamber strongly support the rights of those whom have been truly injured to receive just and timely compensation through our legal system. Lawsuit abuse, however, is actually preventing these victims from being compensated. Frivolous lawsuits are hitting the pocketbooks of hard-working Americans, threatening their jobs and raising the prices of the goods and services they consume.

So, on behalf of the U.S. Chamber Institute for Legal Reform and the U.S. Chamber, I urge you and your fellow Members of Congress to take swift action to pass the vital legal reforms, thereby saving American jobs and strengthening America's small businesses, the backbone of the nation's economy.

For our part, ILR will not rest until our justice system is simpler, fairer and faster for every individual, every family, and every business throughout the United States. I am happy to answer any questions you may have. Thank you.

TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

NFIB
The Voice of Small Business®

Testimony of

Karen R. Harned

On Behalf of the National Federation of Independent Business

before the

United States House of Representatives

Committee on Small Business

on the subject of

Liability Reform and Small Business

on the date of

May 17, 2007

Thank you, Madame Chairwoman and distinguished Committee members for inviting me to provide testimony regarding the tremendous negative effects lawsuits, and the fear of lawsuits, are having on the millions of small-business owners in America today. My name is Karen Harned and I serve as Executive Director of the National Federation of Independent Business (NFIB) Legal Foundation, the legal arm of NFIB. The NFIB Legal Foundation is charged with providing a voice in the courts for small-business owners across the nation.

NFIB is the nation's leading advocacy organization representing small and independent businesses. A nonprofit, nonpartisan organization founded in 1943, NFIB represents the consensus views of its members in Washington and all 50 state capitals. NFIB members represent an important segment of the business community – a segment with challenges and opportunities that distinguish them from publicly traded corporations.

Recent press attention and public outrage has focused on the outlandish $65 million lawsuit filed against a District of Columbia dry cleaner for a missing pair of pants. As outrageous as the facts of this suit are, it is not outrageous that the defendant is a small business. The fact is that NFIB members, and the millions of small businesses across the country, are prime targets for these types of suits because they do not have the resources to defend them. Small businesses cannot pass on to consumers the costs of liability insurance or paying large lawsuit awards without suffering losses.

Being a small-business owner means, more times than not, you are responsible for everything – taking out the garbage, ordering inventory, hiring employees, dealing with the mandates imposed upon your business by the federal, state and local governments, and responding to threatened or actual lawsuits. For small-business owners, even the threat of a lawsuit can mean significant time away from their business. Time that could be better spent growing their enterprise and employing more people.

The NFIB Legal Foundation applauds the Committee for holding this hearing in order to focus on the impact of lawsuits on small business and the need for liability reform.

Our Current "Sue First" Culture Creates a Climate of Fear for America's Small Businesses

Small-business owners rank the "Cost and Availability of Liability Insurance" as the second-most important problem facing small business today, according to a 2004 survey by the NFIB Research Foundation.[1] The only problem that ranked higher is health-care costs.

[1] "Small Business Problems and Priorities," Bruce D. Phillips, NFIB Research Foundation. (June 2004).

This number two ranking represents a significant increase from the 13th position held in the 2000 "Small Business Problems and Priorities" survey.[2] More than 30% of businesses today regard the "Cost and Availability of Liability Insurance" as a critical issue, compared to 11% in 2000 – a threefold increase.[3] With a dramatic rise in the cost of lawsuits[4], it is not surprising that many small-business owners 'fear' getting sued, even if a suit is not filed."[5] That possibility – the fear of lawsuits – is supported by a NFIB Research Foundation National Small Business Poll, which found that about half of small-business owners surveyed either were "very concerned" or "somewhat concerned" about the possibility of being sued.[6] The primary reasons small-business owners fear lawsuits are: (1) their industry is vulnerable to suits; (2) they are often dragged into suits in which they have little or no responsibility; and (3) suits occur frequently.[7]

Moreover, in our "sue first" culture, small-businesses are finding themselves, more often than not, paying for legal services. An NFIB Research Foundation Small Business Poll finds that 65% of small businesses "sought legal advice from or consulted with a layer in the last year" and 78% sought legal advice or help in the last three years.[8] The median number of consultations in the last year was between three and four, with owners of the smallest businesses consulting an attorney between two and three times compared to larger small businesses who consulted them between five and six.[9] However, 14% of small businesses consulted their lawyer 11 or more times a year, which suggests the presence of important legal issues.[10]

The median cost for these services was $4,000 - $5,000.[11] Importantly, one in ten small businesses incurred legal expenses of $25,000 or more.[12] The average NFIB member has gross sales of $350,000. This number does not take into consideration the additional expenses of running a business, such as payroll, rent, cost of goods sold, or regulatory costs. After these expenses are deducted from gross income, a company's net profit is significantly lower, and owners cannot afford the additional expense of legal services.

The bottom line is that the escalating number of lawsuits (threatened or filed) is having a negative impact on small-business owners. For five years, as Executive Director of NFIB's Legal Foundation, I have heard story after story of small-business

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2 "Small Business Problems and Priorities," William J. Dennis, Jr., NFIB Education Foundation (May 2000).

3 "Small Business Problems and Priorities," (June 2004), at 7.

4 "U.S. Tort Costs: 2003 Update, Trends and Findings on the Costs of the U.S. Tort System," Tillinghast-Towers Perrin, 2003.

5 *Id.* at 7-8.

6 NFIB National Small Business Poll, "Liability," William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol. 2, Issue 2 (2002).

7 *Id.* at 1.

8 NFIB National Small Business Poll, "The Use of Lawyers," William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol.5, Issue 2 (2005).

9 *Id.* at 2

10 *Id.*

11 *Id.*

12 *Id.*

owners spending countless hours and often significant sums of money to settle, defend, or work to prevent a lawsuit.

For the small-business owner with five employees or less, the problem is the $5,000 and $10,000 settlements, not the million-dollar verdicts. Small-business owners are troubled by the fact that sometimes they are forced to settle a case at the urging of their insurer. In most cases, if there is any dispute of fact, the insurer will perform a cost-benefit analysis. If the case can be settled for $5,000, the insurer is likely to agree to the settlement because generally it is less expensive than litigating, even if the small-business owner would ultimately prevail in the suit.

Once the suit is settled, the small-business owner must pay through higher business insurance premiums. Typically, it is the fact that the small-business owner settled a case, for any amount, which drives up insurance rates; it does not matter if the business owner was ultimately held liable after a trial. Not surprisingly, an NFIB Research Foundation National Small Business Poll shows that 64% of small employers believe that the biggest problem today with business insurance is cost.[13] Many small-business owners understand this dynamic, and as a result, settle claims without notifying their insurance carriers.

Settling a case also imposes significant psychological costs on small-business owners. Small-business owners threatened with lawsuits often would prefer to fight in order to prove their innocence. They do not appreciate the negative image that a settlement bestows on them or on their business.

The Impact of Lawsuits on Small Business

We would all like to think that attorneys comply with the highest ethical standards; unfortunately, this is not always the case. In my experience, this seems particularly true of plaintiffs' attorneys who bring lower-dollar suits – the type of suits of which small businesses are generally the target. In many instances, a plaintiff's attorney will just take a client at his or her word, performing little, if any, research regarding the validity of the plaintiff's claim. As a result, small-business owners must take time and resources out of their business to prove they are not liable for whatever "wrong" was theoretically committed. As one small-business owner remarked to me, "What happened to the idea that in this country you are innocent until proven guilty?"

Although that mantra refers to a defendant's rights in our criminal justice system, problems with our civil justice system can no longer be ignored. It is incumbent upon the attorney representing a plaintiff to get the facts straight ***before*** sending a threatening letter or filing a lawsuit, not after the letter is sent or the lawsuit is filed. Sadly, we have a legal system in which many plaintiffs' attorneys waste resources and place a significant drain on the economy by making the small-business owner do the plaintiff's attorney's homework. It often is up to the small-business owner to prove no culpability in cases

[13] NFIB National Small Business Poll, "Business Insurance," William J. Dennis, Jr., NFIB Research Foundation Series Editor, Vol. 2, Issue 7 (2002).

where a few hours of research, at most, would lead the attorney for the plaintiff to conclude that the lawsuit is unjustified.

Small business is the target of so many of these frivolous suits because trial lawyers understand that a small-business owner is more likely than a large corporation to settle a case rather than litigate. Small-business owners do not have in-house counsels to inform them of their rights, write letters responding to allegations made against them, or provide legal advice. They do not have the resources needed to hire an attorney nor the time to spend away from their business fighting small-claim lawsuits. And often they do not have the power to decide whether or not to settle a case – the insurer makes that decision.

Frivolous Lawsuits Come in Many Shapes and Sizes

Frivolous lawsuits take several different forms, and I will highlight those types of suits that have been brought to my attention. I place these suits into four categories – "You look like a good defendant", "Pay me now, or I'll see you in court"; "Somebody has to pay, and it might as well be you"; and "Yellow Page lawsuits."

"You look like a good defendant."

One of the most prevalent forms of lawsuit abuse occurs when plaintiffs or their attorneys are merely trolling for cases. A plaintiff, or an attorney, will travel from business to business, looking for violations of a particular law. In such cases, the plaintiff generally is not as concerned with correcting the problem as he or she is in extracting a settlement from the small-business owner.

This was exactly the method of operation for serial plaintiffs, Jarek Molski, George Louie and Jerry Doran, who have filed over 1,000 lawsuits combined. In each case, the men allege that the business has violated an accessibility provision within the Americans with Disabilities Act (ADA) and files suit without ever mentioning the problem to the business owner. These men and their attorneys have intimidated hundreds of small businesses into settling their cases.

At least one NFIB member, Mike Lee of Pismo Beach, Calif., settled with Mr. Molski. Mr. Lee owns a small seafood restaurant with 17 tables and no bar, but that did not prevent Mr. Molski from filing suit before ever complaining to Mr. Lee that his restaurant was out of compliance. "The night I got sued, he went to four places the same night," Lee said. The complaint ended up costing Mr. Lee more than $50,000 after he paid his insurance deductible, legal fees and renovation costs.

Mr. Molski's tactics went completely unchallenged by small businesses until 2004 when one small business took on the fight. The court sided with the small business, labeling Mr. Molski as a "vexatious litigant." However, not all small-business owners are able to challenge these "drive-by lawsuits." Only in rare instances do these small businesses have the resources and principled desire to fight frivolous threats. Those that

fight the baseless claims are often "rewarded" by plaintiffs' attorneys, who decide to forego pressing the claim in favor of choosing another target. Those who settle often become targets again at a later date.

Plaintiffs are not the only ones trolling for cases. In California, attorneys have been known to rake in several million dollars a year fleecing small-business owners. One particularly attorney, Harpreet Brar, received hundreds of settlements of $1,000 or more from 'mom and pop' stores throughout the state after suing them for minor violations of the state business code. Mr. Brar sued many of these businesses for allegedly collecting "point-of-sale" device fees from his wife without proper disclosure signs.

Also in California, three lawyers working for the Trevor Law Group, a Beverly Hills law firm, made small fortunes shaking down thousands of small business owners. Specifically, the law firm targeted more than 2,000 auto-repairs shops in California for "unfair business practices." These attorneys, like Mr. Brar, used broad consumer protection statutes (which have subsequently been invalidated) to go after those people considered most likely to settle-our nation's small business owners.

Most recently, the case brought by a District of Columbia administrative law judge against a small dry cleaner highlights how attorneys are contorting consumer protection laws to siphon cash out of small businesses. Plaintiff and attorney Roy Pearson is suing a family-owned dry cleaner shop for a lost-and-found pair of pants. The owners attempted to settle with Pearson. However, he refused and instead brought a suit claiming that the shop was violating District of Columbia consumer protection laws. He alleges that the shop's satisfaction guaranteed and same day service guarantee were not met and, therefore, they are liable for $1500 per day, per violation, per person. By suing the shop owner, his wife and their son, and adding in $500,000 for emotional damages, $542,500 in legal fees, (despite the fact that he is representing himself in court) and $15,000 for 10 years' worth of weekend car rentals, Pearson is claiming he is owed over $65 million dollars. This is clearly not what the consumer protection statute was intended to provide.

"Pay me now, or I'll see you in court."

An increasingly popular tool, which can be quite effective against the small-business owner, is the "demand" letter. In my experience, plaintiffs and their attorneys find "demand" letters particularly attractive when they can file a claim against a small-business owner for violating a state or federal statute. Generally, on behalf of a plaintiff, an attorney will send a one and a half to two-page letter alleging the small business violated a particular statute. The letter is replete with cites to statutes and case law. At some point, the attorney's letter states that the business owner has an "opportunity" to make the whole case go away by paying a settlement fee up front. Timeframes for paying the settlement fee are typically given. In some cases, there may even be an "escalation" clause, which raises the price the business must pay to settle the claim as time passes. So, a business might be able to settle for a mere $2,500 within 15 days, but

if it waits 30 days, the settlement price "escalates" to $5,000. At some point, however, a suit is threatened. Legal action is deemed imminent.

An example of such a case was a suit threatened against Custom Tool & Gage, Inc. owned by Carl T. Benda and located in Cleveland, Ohio. Custom Tool received a demand letter claiming that Miller Bearing Company had received an illegal fax from them and demanded a settlement. Custom hired an attorney who sent a response letter indicating that the plaintiff in the case, James Brown, was neither the owner nor the buying agent for Miller Bearing Company Inc., the business that received the fax. Miller Bearing Company is a regular customer of Custom Tool & Gage, Inc. and had placed five orders with Custom Tool & Gage, Inc. in 2004 alone. James Brown was a truck driver for Miller Bearing Company, and not authorized to file such a lawsuit on behalf of the company. That fact would have taken little time for Mr. Brown's attorney, Joseph Compoli, Jr., to uncover. The plaintiff in the case ultimately withdrew his complaint one week after threatening legal action against Custom Tool & Gage, Inc.

Below are excerpts of the "demand" letter sent to Custom Tool & Gage, Inc. The letter was accompanied by a signed complaint, which was ready to be filed in the Court of Common Pleas for Portage County, Ohio. I request that a copy of the letter, the complaint, the subsequent correspondence leading to the withdrawal of the suit, and a March 3, 2004 newspaper article discussing the tactics employed by Mr. Joseph Compoli, Jr. in similar "do not fax" suits be admitted into the record.

> This office represents the above referenced client. We have been retained to bring a lawsuit against Custom Tool & Gage, Inc., in connection with your transmitting of one unsolicited facsimile ("fax") advertisement to our client....
>
> Kindly be advised that it is a violation of the Telephone Consumer Protection Act (TCPA), Title 47, United States Code, Section 227, to transmit fax advertisements without first obtaining the 'prior express invitation or permission' of the recipient. *See,* 47 U.S.C. 227(a)(4) and 227(b)(1)(C). In addition, Ohio courts have declared that a violation of the TCPA is a[n] [sic] 'unfair or deceptive' act or practice under the Ohio Consumer Sales Practices Act (CSPA), Section 1345.02(A) of the Ohio Revised Code.
>
> We are sending you this letter for the purpose of offering you an opportunity to resolve this matter without the expense of court litigation and attorneys['] [sic] fees. We are authorized to amicably settle this claim for the amount of **$1,700**. This amount represents the sum of $1,500 under the TCPA and $200 under the CSPA for each

> unsolicited fax advertisement[,] [sic] which was received by our client.
>
> ...
>
> We believe that our proposed settlement is very fair and reasonable under the circumstances. We will leave this offer open for fifteen (15) days from the date of this letter.
>
> Recently, in the case of *Nicholson v. Hooters of Augusta*, a court in Georgia awarded over $11.8 million in a class action lawsuit under the TCPA. Also, more recently, in the case of *Gold Seal Termite & Pest Control v. Prime TV LLC*, a court in Indiana has certified a **nationwide class action** against Prime TV for sending unsolicited fax advertisements.
>
> If it becomes necessary for our office to file a lawsuit, we will pursue all legal remedies, including seeking certification of the case as a Class Action under the TCPA. This could result in a court order for *you* to pay *$1,500* to each and every person to whom you have sent unsolicited fax advertisements.
>
> If you have an insurance agent or company, please forward this letter to your agent or insurance company. If not, please contact our office directly.[14]

Even though this case was completely baseless, Mr. Benda still was required to spend $882.60 (over half the amount of the proposed settlement costs) to his attorney to draft the letter and avoid payment of the settlement. I am saddened to report that since I first shared this story with Congress almost three years ago, I continue to hear from small businesses about Mr. Compoli's aggressive litigation tactics.

"Somebody has to pay, and it might as well be you."

These frivolous suits are the type in which the plaintiff may have been harmed, but is suing the wrong person.

For example, Bob Carnathan, an NFIB member, owns Smith Staple and Supply Co., a small nail and staple fastening business located in Harrisburg, Pennsylvania. Mr. Carnathan's business leases space in a strip mall. After a snowstorm, one of the tenants in the complex was walking across the parking lot when he slipped and fell on the icy

[14] Letter dated March 11, 2004 from Joseph R. Compoli, Jr., Attorney at Law, to Custom Tool & Gage, Inc.

pavement injuring his back and head. The medical bills from his injury totaled a little over $3,000. The man sued every tenant in the complex, as well as the landlord and the developer, for $1.75 million. Mr. Carnathan was sued even though he was not at fault because his rent included maintenance on the facilities and grounds.

After two years of endless meetings and conference calls, Mr. Carnathan learned that his business was released from the lawsuit. He says that there is no compensation for the time that he was forced to spend away from his business to fight this unfair lawsuit. Mr. Carnathan firmly believes that "the smaller your business, the more you are impacted when a frivolous lawsuit lands on your doorstep."[15]

"Yellow Page Lawsuits"

These lawsuits are more commonly found in class action cases. In these cases, hundreds of defendants are named in a lawsuit, and it is their responsibility to prove that they are not culpable. In many cases, plaintiffs name defendants by using vendor lists or even lists from the Yellow Pages of certain types of businesses (e.g., auto supply stores, drugstores) operating in a particular jurisdiction.

Unfortunately, Tom McCormick, President of American Electrical, Inc. in Richmond, Virginia, knows these tactics all too well. Mr. McCormick's company was named in an asbestos lawsuit. According to Mr. McCormick, attorneys for the plaintiffs simply named as defendants vendors from a generic vendor library. If the lawyers had performed a simple review of the facts, they would have discovered that American Electrical did not yet exist during the period in which the plaintiffs allege the exposure occurred. Furthermore, American Electrical has never sold any products that contain asbestos. Fortunately, Mr. McCormick successfully had American Electrical removed from the defendant list. It still cost Mr. McCormick $8,000 in attorney's fees to resolve this dispute.

"Yellow Page Lawsuits" also allow plaintiff's attorneys to forum shop. Hilda Bankston, former owner of Bankston Drugstore in Jefferson County, Mississippi, saw her business named as a defendant in hundreds of Fen-Phen lawsuits brought by plaintiffs against a number of pharmaceutical manufacturers.[16] Ms. Bankston said that Bankston Drugstore was the only drugstore in Jefferson County and, by naming it in these lawsuits, the plaintiffs' attorneys were able to keep these cases in "a place known for its lawsuit-friendly environment."[17]

Indirect Effects of a "Sue First" Culture on Small Business

The fear of lawsuits carries with it a price premium. Companies that are unable to obtain insurance, or cannot do so at a reasonable cost, build the cost of potential litigation

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[15] The NFIB Small Business Growth Agenda for the 108th Congress, at 15.

[16] Testimony of Ms. Hilda Bankston before the United States Senate Committee on the Judiciary, "Class Action Litigation," (July 31, 2002).

[17] *Id.*

into the cost of goods or services they provide. This raises the costs for everyday consumers like you and me. In addition, these companies often cannot afford to hire additional workers or to sustain employment levels after being threatened with suit.

The fear of lawsuits has extended beyond just the business owners to the insurers. The inability to obtain certain forms of liability insurance leaves small businesses incapable of protecting themselves at a reasonable cost. For example, NFIB member Barry French is a well known inventor of a mattress sensor device designed to measure an infant's heartbeat and apnea in order to combat Sudden Infant Death Syndrome (SIDS). He was unable to obtain product liability insurance on the product. One insurer commented that he believed that the sensor device had the potential to save dozens if not hundreds of infant lives annually, but if one child sleeping on the sensor died, regardless of the cause, the parties would face substantial damages. The only company that agreed to insure him quoted a cost that would have doubled the retail price. If new inventions become prohibitively expensive because of the cost of insurance, they will have a limited market. This chips away at an inventor's incentive to continue developing new products.

Some types of liability, such as punitive damages, are not insurable in many states. Thus, a small business with relatively low net income cannot afford to pay a one million dollar punitive damage claim. This is exactly what happened to Frank Ciotola, owner of Davincis' Ristorante in Ohio. A patron of his restaurant tripped on a well-marked step, and subsequently filed suit asking for compensatory and punitive damages. While Davincis' had insurance to cover any award of compensatory costs, there was nothing other than company assets to pay for the punitive damages. If the company had not settled the claim, it would have been forced to go out of business and 70 employees would be out of work.

The fear of litigation deters these businesses from introducing innovative products, hiring additional workers and investing. As the backbone of America's economy, subjecting small businesses to this kind of restraint undoubtedly affects the greater economy.

Solutions for Small Business

Surveys, statistics, and stories show that lawsuit abuse is alive and well in the United States, and small businesses are often the victims. It is for this reason that legislation is sorely needed to reform our nation's civil justice system. There are several reforms that would take positive steps in stemming the tide of lawsuit abuse. These include the following suggestions.

Since 1993, Rule 11 has been hamstrung by changes that diluted its ability to prevent frivolous lawsuits. In order to help restore fairness to the legal system, Congress should pass legal reform that makes Rule 11 sanctions mandatory for frivolous lawsuit filers.

Congress should also pass legislation that would prevent frivolous food lawsuits. Food-related businesses should not be held responsible for providing customers with the food they want. These lawsuits deny the role that personal responsibility plays in the dietary choices of individuals. An overwhelming majority of Americans -- 89 percent, according to one Gallup Poll -- believe that the food industry should not be blamed for issues related to obesity.

Product-liability laws are intended to protect consumers from injury due to unsafe products. However, the current product-liability law does not distinguish between the manufacturer and seller of a product and makes product sellers potentially liable for defects they are not aware of or could not discover. This has resulted in product sellers -- often small retail businesses -- being unfairly dragged into lawsuits for defective products. The uncertainties in the product-liability system create unnecessary legal costs, impede commerce and stifle innovation.

NFIB supports establishing a product-liability standard that distinguishes sellers from manufacturers and a uniform statute of limitations in product-liability cases. These reforms would protect small retail shops from lawsuits over products they did not make. Product sellers should be liable only if they are directly at fault for harm.

Under current law, small-business owners who are wrongly accused of violating laws or regulations often must pay attorney fees and other costs to extricate themselves from government penalties. The Equal Access to Justice Act is intended to help small businesses recover attorney fees when they prevail in a suit against the government. However, EAJA only allows recovery if the agency fails to show that the action was substantially justified. Unfortunately, this loophole in the law allows agencies to avoid granting reimbursements, and as a result, EAJA applications are rarely filed. NFIB supports legislation that would close the loophole and truly reimburse innocent small-business owners who successfully defend themselves against wrongful government prosecution.

The explosion in the size of punitive damages has helped cause the legal system's downward spiral. These damages do not go toward compensating victims; instead they serve to destroy small businesses. NFIB believes that reforms are needed to help prevent excessive punitive damage awards.

Joint-and-several liability is also a small business killer. NFIB urges Congress to abolish this type of liability and instead institute a fairer, "fault-based" system, so that defendants are only held liable for their specific degree of fault.

Conclusion

Our "sue first" culture is hurting small-business owners, new business formation, and job creation. The growing number and costs of lawsuits, particularly those not based in fact, threaten to stifle significantly the growth of our nation's economy by hurting a very important segment of that economy, America's small businesses. We must work

together to find and implement solutions that will stop this wasteful trend. On behalf of America's small-business owners, I thank this Committee for holding this hearing and providing us with a forum to tell our story.

We are hopeful that through your deliberations you can strike the appropriate balance to protect those who are truly harmed and the many unreported victims of our nation's civil justice system – America's small businesses.

Thank you.

NFIB CORE VALUES

- We listen and respond to our members' needs.
- We are committed to exceeding our members' expectations.
- We are committed to excellence in advocacy and all we do on behalf of our members.
- Our members determine the public policy positions of the organization – one member, one vote.
- We expect the highest ethical standards in all our activities.

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Testimony of Steve Kelly
Chairman, National Lumber and Building Material Dealers Association
House Committee on Small Business
Hearing on "Liability Reform and Small Business"
May 17, 2007

I want to begin by thanking you, Madam Chairwoman, as well as Ranking Member Chabot for holding this hearing today to examine an issue that impacts nearly every small business, namely, the threat of lawsuits. I commend you for exercising your oversight duties to learn how unfounded lawsuits harm small businesses and depress our economy.

My name is Steve Kelly. I am the owner and President of Kelly Brothers Lumber in Covington, Kentucky. My company has been family-owned and operated for more than 50 years. We employ 42 employees and serve homeowners and professional contractors in Kentucky, Ohio and Indiana.

I currently serve as Chairman of the National Lumber and Building Material Dealers Association (NLBMDA) which represents 8,000 lumber and building material dealers, 20 state and regional associations and the industry's leading manufacturers and service providers. NLBMDA's members and their 400,000 employees supply the majority of the building products sold in the United States to professional contractors, home builders and remodelers.

Madam Chairwoman, the specter of litigation touches nearly every small business operating in the United States at one point or another. I am here today to highlight the impact predatory lawsuits have on the building supply industry.

Most lumberyards and building suppliers are small, family-owned businesses which operate in the very communities in which the esteemed members of this Committee reside. They pay taxes, sponsor charitable events, and participate in community activities.

Here's the problem: unfounded and unfair lawsuits are increasing and they are having a negative effect on the ability of lumber dealers to operate our businesses. In fact, a 2005 survey of NLBMDA members found that approximately 1 in 4 has been the victim of a product liability lawsuit within the previous five years. And in almost every one of those cases, the dealer did not design, manufacture, alter, or install the product.

Our current liability system holds each party in the product supply chain liable for any defects or harm caused by the product without any finding of fault. While I agree that the consumer should be protected from harm or inconvenience caused by defective products, I do not believe the legal system assigns liability in a fair and consistent way. A building materials dealer who simply sells a product should <u>not</u> be burdened with 100 percent of the liability when that product fails.

Let me offer a few examples to illustrate how the current system punishes small business owners like me.

A dealer in Ohio sold slate-style shingles to a customer. The shingles were shipped directly from the wholesaler to the jobsite; the dealer never saw nor touched the product. The coating later wore off some of the shingles, resulting in a spotty appearance, and the dealer was forced to pay $16,000 in a settlement.

Another dealer sold bricks, manufactured independently of the dealer and delivered directly to a customer. The dealer was named a codefendant in a lawsuit claiming manufacturing defects and encouraged by his insurance company to settle the case to avoid a court battle.

In Utah, a dealer sold a hammer to his attorney. The attorney's son went out and hammered rocks, causing the head of the hammer to fly off and injure his eye. The attorney sued the dealer.

Another dealer sold a water heater to a customer. The customer chose to ignore the manufacturer's instructions and install the water heater himself, rather than use a licensed contractor. The water heater was improperly installed and exploded, causing property damage and, unfortunately, the death of the customer. The dealer has spent three years and over $50,000 in legal fees just to try to be released from the case, which is still ongoing. While certainly tragic, it is unfortunate that an innocent retailer is dragged into a court battle simply because a product he sold was improperly installed.

In Texas, a lumber dealer sold a 2x10x24 board to a contractor who used it for scaffolding. While two people were standing on it, the board broke. One of the individuals was able to catch himself, but the other fell and was hurt. They are suing the lumber company for selling them a "defective" board, even though it was never suitable for scaffolding purposes. The case is still pending and has already cost the lumber dealer thousands of dollars to defend.

These are just a few of the lawsuits occurring in our industry where innocent sellers are forced to spend time and money defending themselves for actions outside of their control. Fortunately, there is a solution to this problem. Ranking Member Chabot, along with Representative Dan Boren, has introduced legislation to assign liability on a proportionate basis. The Innocent Sellers Fairness Act (H.R. 989) would protect sellers from predatory lawsuits by removing liability if they merely supplied the product and had no part in its manufacturing, design, or installation. Instead of imposing the archaic standard of "joint and several" liability, the bill would hold sellers responsible only in proportion to their wrongdoing, freeing them from liability when they have done nothing wrong.

The Innocent Sellers Fairness Act is necessary because current law imposes liability without wrongdoing by sellers, exposing them to all of the damages allegedly suffered by a plaintiff, even though other defendants may have played a much greater

role in causing the damages. The "mistake" may have been in the manufacture or design of the product, or even in a customer's improper use of the product, but somehow the seller is stuck with some or all of the liability.

No amount of care can free a seller from disproportionate product liability, and plaintiff's lawyers know this. They routinely sue anyone in the chain of distribution of a product and often force settlements out of otherwise innocent merchants. Suing sellers is standard operating procedure. Often, sellers choose to settle a case to avoid the uncertainty of a trial outcome and the bad press that often follows.

The current system does not do enough to protect the truly innocent. According to Small Business Administration (SBA) estimates, the cost of defending predatory lawsuits can run as high as $100,000, typically forcing dealers to settle regardless of the merit of the case. For a typical building material supplier with $1 million a year in revenue, the average tort liability cost is $17,000 per year.

The Innocent Sellers Fairness Act would restore common sense to the legal system. It is not designed to let negligent dealers off the hook, but rather, to ensure that truly innocent sellers are not left holding the bag when the fault lies elsewhere. Congressman Chabot, on behalf of NLBMDA and innocent sellers around the country, I want to thank you for your leadership in fighting unfair lawsuits and championing legal reform. I look forward to working with this Committee to address these problems and ensure that America's small businesses operate in a legal environment that is fair for everyone. The Innocent Sellers Fairness Act is designed to accomplish this goal.

Thank you, Madam Chairwoman, for the opportunity to present the building supply industry's call for relief from predatory lawsuits before this Committee.

TESTIMONY OF
DR. PAUL FREEDENBERG
VICE PRESIDENT – GOVERNMENT RELATIONS
AMT — THE ASSOCIATION FOR MANUFACTURING TECHNOLOGY

U.S. HOUSE OF REPRESENTATIVES
Committee on Small Business

MAY 17, 2007

Madame Chairwoman and members of the Committee, thank you for holding this hearing today and for giving me the opportunity to be here and participate.

My name is Paul Freedenberg. I am Vice President of Government Relations at AMT - The Association For Manufacturing Technology.

Before I speak, and pursuant to House Rule XI, I am obliged to report that AMT received $225,100 from the Commerce Department's Market Co-operator Development Program for a technical center in China -- $207,254 of which was disbursed in 2005 and $17,846 in 2006.

AMT is a trade association whose membership represents over 400 manufacturing technology providers located throughout the United States, almost the entire universe of machine tool builders who operate in our country. Most of these companies are small -- an estimated 78 percent of them have less than 50 employees. But what they contribute is huge.

They are the ones who build the machines that make things work. In fact, everything in this hearing room except the people, of course, was either made by a machine tool or made by a machine made by a machine tool.

We are an essential part of America's manufacturing base, providing a wide range of industries the manufacturing technology they need to produce – from cutting,

grinding, forming and assembly machines to inspection and measuring machines and automated manufacturing systems.

AMT has testified many times over the years before this and other Committees on the need for product liability reform – and that's what I would like to again address today. For most small American businesses – and specifically for our members – product liability is not a distant issue but one that can literally make or break our companies.

Several AMT members have been forced to close their doors because of product liability lawsuits. Others are in danger of closing because litigation costs are strangling them. They are spending money *not* on hiring more workers or improving productivity but rather on defending against lawsuits involving machines that are often older than anyone in this room. These lawsuits also significantly impact their ability to survive in a globally competitive world.

The cost of litigation is significant because our industry is very cyclical. Price pressures are very strong, and profitability is relatively low – even in good years. U.S. consumption of machine tools is 12 percent higher than a year ago, outpacing 11 percent growth in U.S. production.

Where our industry is most vulnerable in terms of product liability is in over-age machine tools. AMT estimates that the average age of machine tools has climbed from 10 years in 1998 to nearly 13 years in 2005. The reason largely is because, when a

factory decides to invest in new capital equipment, the old machinery is usually not disposed of. When companies can't afford new machines they purchase these over-age machines, often altering them to fit their needs. This process is repeated, as newer machines are acquired and older ones resold. The result is a big overhang of over-age machine tools in the U.S. market. And this exposes the manufacturers of the old equipment to costly litigation.

One reform that could significantly help reduce those crippling costs, Madame Chairwoman, would be creation of a statute-of-repose for workplace durable goods.

A statute-of-repose measures the time limitation from the date of the initial sale of the capital equipment. Statutes of limitations, by contrast, typically impose a time limit measured from the time of the injury or the discovery of its cause.

In many states today, thanks to product liability law, the potential liability for my industry's products is endless – literally "forever." Many of these machines – built before OSHA was created, before Neil Armstrong walked on the moon and before the Beatles came to America – are still in use today.

Although these machines were built decades ago to safety standards of their day and although they are likely to have passed through several owners – each of whom likely made modifications to accommodate their needs – they are still the subject of

four-fifths of our industry's lawsuits.Safety features built into the original equipment have sometimes been negligently or intentionally disabled by employers or workers in an effort to increase production or avoid the "nuisance" of dealing with guards, lock-out mechanisms, and other safety features. But proving such circumstances is extremely difficult, leaving the original machine tool manufacturer facing litigation because of circumstances completely beyond their control.

Madame Chairwoman, I think under circumstances in which our machine tool makers have not exercised control over a product for a long time, it is unreasonable and unfair to hold them accountable for the product's performance.

This kind of litigation is disproportionately expensive and socially unproductive. It is a drain on financial resources, not only from the adverse verdicts, but from the costs of successful defense. The reality is, most cases involving over-age machines never go to trial, and if they do, a jury almost always finds for the defendant. And, in those cases that do go to trial in which the jury finds for the claimant, the judgment can force a company to close its doors. In 1996, a $7.5 million verdict involving a machine built in 1948 against Mattison Technologies, a 100-year-old Illinois machine-tool builder, led to the company's bankruptcy.

However, even when these lawsuits are "won," the litigation nevertheless results in unnecessarily high legal and transaction costs. No matter how frivolous the actual facts, the claimant's pleadings must be answered, depositions taken, design experts consulted, and historical records, if any, unearthed and evaluated. The result is a

substantial expenditure of funds, additional litigation in our courts, and the diversion of resources that could be invested in greater competitiveness. Insurers know this and factor it into insurance premiums.

This type of open liability also tends to feed legal extortion, in which baseless suits are filed by entrepreneurial lawyers who are banking on the fact that many companies and/or their insurers will pay an out-of-court settlement rather than accept the risk and high cost of going to trial.

Madame Chairwoman, most of our machine tool builders – particularly our small ones – just cannot afford this type of unfair liability at a time when they are facing serious and increased competition from foreign companies.

The incursion by foreign machine tool builders into the U.S. market is fairly recent (within the past 25 years). As a result, these foreign competitors do not bear the significant long-tail exposure of U.S. builders.

American companies that have been in business for many years must factor into their prices the risk of litigation involving thousands of over-age machines. Our Japanese and European competitors don't have those risks and those costs. Their liability exposure is relatively small (both Europe and Japan have 10-year statutes-of-repose, if they are sued in their home markets).

Enactment of a statute-of-repose for workplace durable goods would significantly level the playing field for U.S. manufacturers and achieve the uniformity and certainty necessary to produce the state-of-the-art products for which we are noted.

Madame Chairwoman, some years ago the Reagan and first Bush Administrations, at the urging of more than 250 Members of Congress, provided temporary import relief for our machine tool industry, based on the threat posed to our national security from Asian machine tool imports. They did so because they recognized that a strong machine tool industry is vital to America's military and economic security.

The same is as true, if not more so, today in terms of the importance of maintaining a strong, American-based machine tool sector. But our current product liability system has cost the manufacturing technology industry jobs, money and time. Advances in high-tech products are slowed as a result, and resources that could have gone toward the development of new technology, expanded jobs and higher productivity for America have been expended on wasteful litigation costs, a significant amount of which never actually benefits an injured worker.

Enactment of meaningful reform, including a statute-of-repose, could significantly improve the competitiveness of U.S. companies -- particularly our small companies -- and still ensure that no injured worker goes uncompensated -- as opposed to meritless lawsuits.

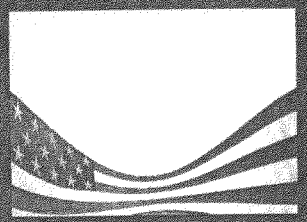
I appreciate the Committee's attention to this issue and would again like to thank the Chairwoman and Congressman Chabot for allowing me to testify – and for Congressman Chabot's perseverance in pursuing product liability reform.

Thank you.

HarrisInteractive

Small Businesses: How the Threat of Lawsuits Impacts Their Operations

NATIONAL SAMPLE



Conducted for

US Chamber Institute for Legal Reform
May 10, 2007

www.harrisinteractive.com

Table of Contents

Research Objectives, Sample and Methodology 3
Summary of Major Findings. 4
Detailed Findings 8
Demographic Profile 29

Research Objectives, Sample and Methodology

- Research Objectives:
  - To examine the attitudes and experiences of small business owners and managers who are concerned about frivolous and unfair lawsuits and to learn how the legal environment, specifically the tort system, impacts their businesses.
- Sample:
  - Nationally representative sample
  - Small business owners obtained from Dun & Bradstreet
  - Small business definition: companies who have revenues of $10 million or less and have at least one employee in addition to the business owner*
  - Must be very or somewhat concerned about the liability system practiced in their respective state
- Sample size and definition:
  - Total 1109. A total of 3390 were contacted of which 1109 qualified. After correctly weighting the data, the qualified sample represents 48% of small businesses nationwide – 16% who are very concerned and 32% who are somewhat concerned. Nonqualified respondents included 30% who were not too concerned, 21% who were not at all concerned and 1% who did not know/refused to answer.
  - All the findings in this report are based on the 48% of small business owners or managers who are very or somewhat concerned that they may be sued in a frivolous or unfair lawsuit. Their views reflect those held by the owners of some 2.8 million companies with nearly $2.3 trillion of annual economic output—or about 20 percent of the gross domestic product—according to the 2002 US Economic Census.
- Data Collection Method:
  - Telephone interviews using the computer-assisted telephone interviewing (CATI) system
  - Interviews conducted November 6, 2006 – February 28, 2007
- Data were weighted using Dun and Bradstreet data to ensure a representative sample
- Margin of sampling error for 1109 interviews is +/- 3 percentage points

*According to the 2002 US Economic Census, there were 5.8 million businesses in this revenue category, with $4.8 trillion in revenues.

Summary of Major Findings

Major Findings

Among business owners/managers who are very or somewhat concerned about lawsuits:

- 62% say they make business decisions to avoid lawsuits. These decisions have had the following effects:
  - 61% made their products and services more expensive.
  - 45% made a product or service unavailable to customers.
  - 23% say these decisions forced them to cut employee benefits.
  - 11% say these decisions forced them to lay off employees.
- 62%, or almost six in ten, feel they would be able to increase revenues if they were assured that they would be protected from frivolous/unfair lawsuits. Only 12% would not be able to do this at all.

Major Findings (Cont.)

- Of those 62% who said they could increase revenues if protected from unfair/frivolous lawsuits, they would largely reinvest these additional revenues in their businesses, and in the following ways:
  - 80% would improve facilities or purchase new equipment.
  - 76% would increase compensation to employees.
  - 69% would expand the market for what they offer.
  - 65% would increase benefits offered to employees.
  - 63% would hire additional employees.
  - 56% would develop new products or services.

- A substantial number of small business owners/managers (46%) have been threatened with an actual lawsuit. These threats have had the following effects:
  - 75% say the threats added time and expense to their business operations.
  - 60% say the threats made them feel more constrained in making business decisions generally.
  - 54% say the threats caused them to make business decisions they would not otherwise have made.

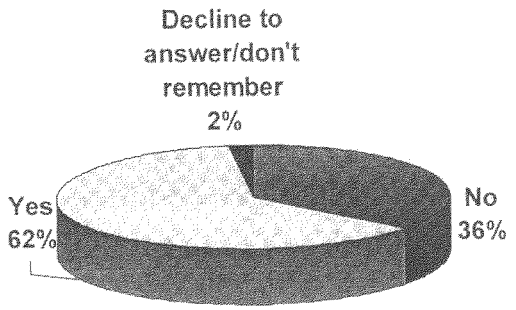
Major Findings (Cont.)

- More than a third (34%) of qualified small businesses have had a lawsuit filed against them in the past ten years. These suits have had the following effects on owners/managers and their businesses:
  - 73% say their business suffered because litigation was very time consuming.
  - 64% say their business suffered because litigation was very expensive.
  - 61% say they felt more constrained in making business decisions generally.
  - 54% say they made a business decision they would not otherwise have made.
  - 45% say they changed business practices in ways that do not benefit customers.

Detailed Findings

Made Business Decision to Avoid Frivolous/ Unfair Lawsuits

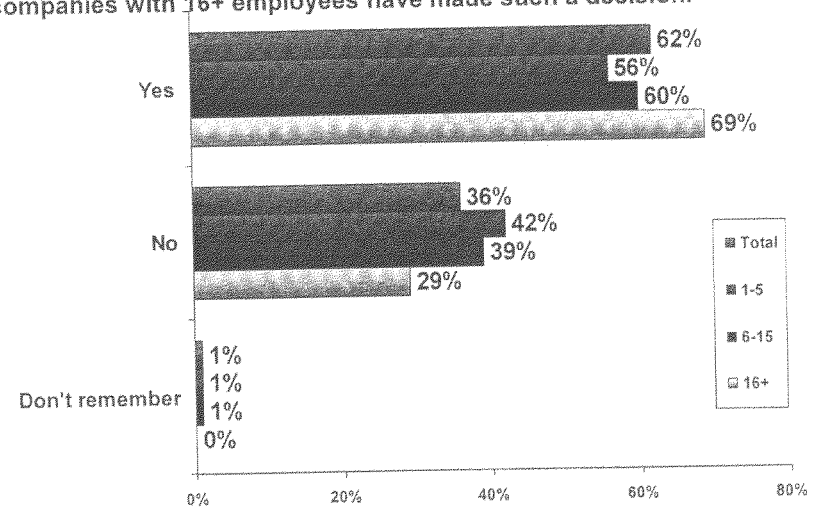
- The threat of frivolous/unfair lawsuits has caused over six out of ten business owners (62%) to make business decisions to avoid such suits.



Base: Concerned, Small Business Owners (n = 1109)
Q500 Have you ever made a business decision primarily to avoid such suits?

Made Business Decision to Avoid Frivolous/Unfair Lawsuits (by Employee Size)

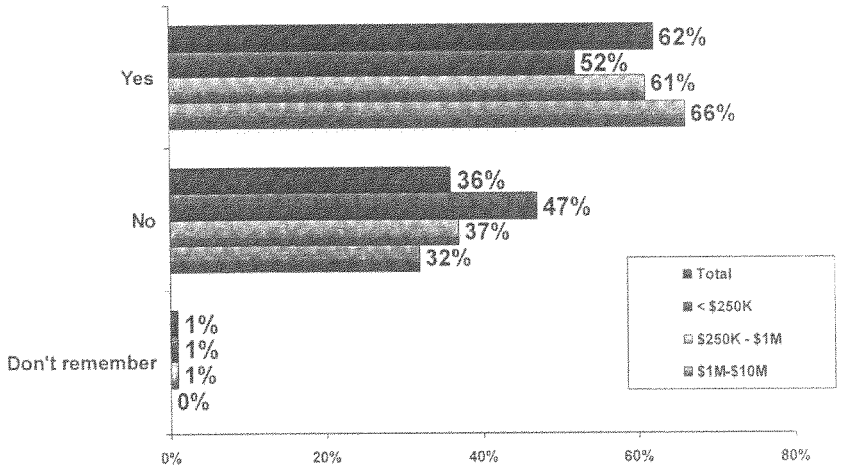
- The more employees a company has, the more likely the company has made business decisions to avoid suits. In fact, almost seven in ten companies with 16+ employees have made such a decision.



Base: Concerned, Small Business Owners (n = 1109)
Q500 Have you ever made a business decision primarily to avoid such suits?

Made Business Decision to Avoid Frivolous/Unfair Lawsuits (by Revenue)

- Small companies with larger revenue are more likely to make business decisions to avoid suits than very small companies.



Base: Concerned, Small Business Owners (n = 1109)
Q500 Have you ever made a business decision primarily to avoid such suits?

Effect on Company of Actions Made to Avoid Lawsuits

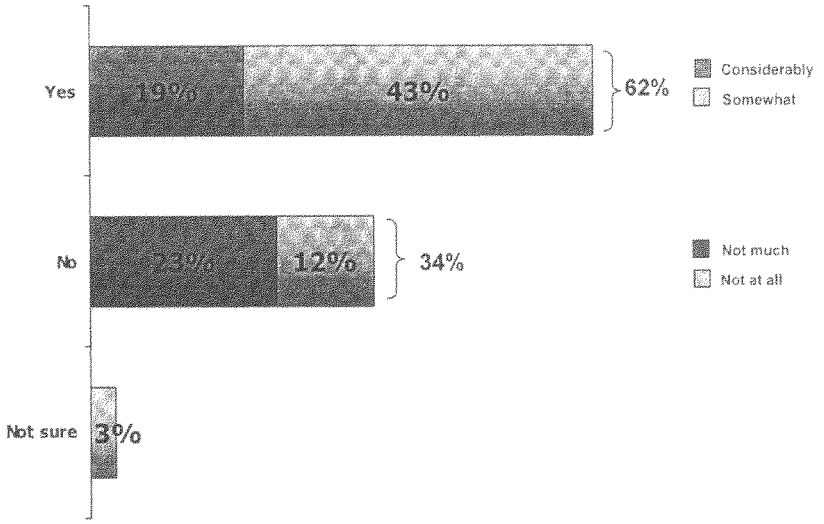
- Actions made to avoid frivolous/unfair lawsuits are most likely to affect companies monetarily, regardless of employee size or revenue.
- Larger small companies with more than five employees and $250,000-$10M in revenue are more likely to see their products/services become more expensive for consumers.
- Almost half of small businesses nationwide have been hesitant in making major business decisions after making a decision to protect against litigation.
- Larger small companies with revenue of $1M-$10M are more likely to cite that their revenue is adversely affected by actions taken to avoid lawsuits.

		Employees			Revenue		
	Total	1-5	6-15	16+	< 250K	250K - 1M	1-10M
Base	(633)	(381)	(127)	(125)	(285)	(190)	(158)
	%	%	%	%	%	%	%
They raised my costs and adversely affected the company's revenue.	67	65	60	71	60	58	72
They have made my products/services more expensive.	61	50	64	66	46	59	66
They made me hesitant to make major business decisions.	48	49	46	47	50	48	47
They made a product or service unavailable to customers.	45	53	39	43	46	48	43
They forced me to cut employee benefits.	23	17	20	29	15	19	27
They forced me to lay off employees.	11	11	10	11	10	11	11
Any other actions	11	12	10	11	11	10	12
Not sure	5	4	8	5	7	7	4

Base: Made Decision to Protect Against Litigation (n = 633)
Q505 How have these actions intended to avoid frivolous or unfair lawsuits affected your company? Multiple Response
Q510 What other ways have these actions affected your company?

Increasing Revenue if Protected from Lawsuits

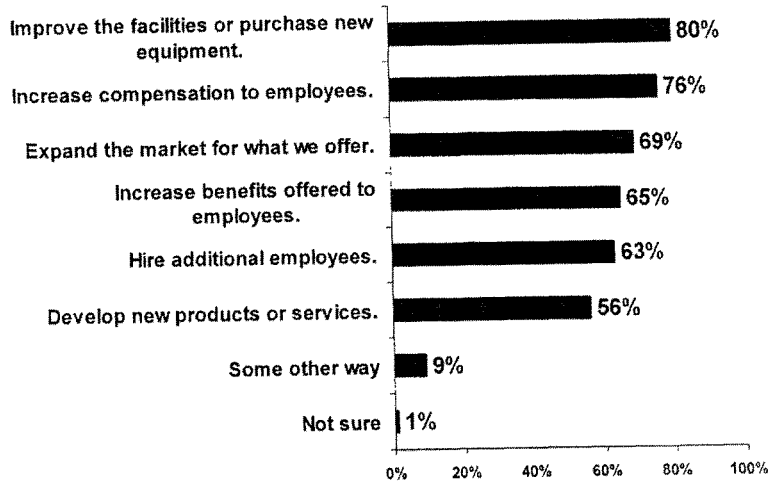
- **Six in ten (62%) small business owners feel they would be able to increase revenue if there was assurance that they would be protected from frivolous/unfair lawsuits; only 12% would not be able to do this at all.**



Base: Concerned, Small Business Owners (n = 1109)
Q515. If you could be assured that you would be protected from frivolous or unfair lawsuits, would you be able to operate your business in a way that would increase revenues?

Ways Increased Revenue Would be Used

- **Small business owners who would be able to increase revenue would most likely spend the additional profit on improvements to facilities or new equipment and increasing compensation to employees.**



Base. Yes, able to increase revenue (n = 655)
Q520 What would you be likely to use those increased revenues for?

Ways Increased Revenue Would be Used (by Employee Size and Revenue)

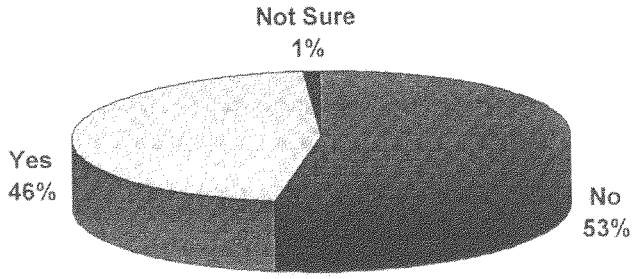
- **There is little difference by size. However, larger small companies are slightly more inclined to increase compensation to employees.**

		Employees			Revenue		
	Total	1-5	6-15	16+	< 250K	250K - 1M	1-10M
Base	(655)	(408)	(125)	(122)	(302)	(201)	(152)
	%	%	%	%	%	%	%
Improve the facilities or purchase new equipment.	80	76	83	82	78	77	83
Increase compensation to employees.	76	68	76	83	69	69	82
Expand the market for the products or services we now offer.	69	64	69	73	68	61	74
Increase benefits offered to employees.	65	64	70	65	63	64	67
Hire additional employees.	63	58	63	66	60	57	67
Develop new products or services.	56	49	57	59	54	50	59
Some other way	9	9	10	8	13	9	7
Not sure	1	0	0	2	1	0	2

Base: Yes, able to increase revenue (n =655)
Q520 What would you be likely to use those increased revenues for?
Q525 What other ways would you be likely to use those increased revenues?

Actual Lawsuit Threats

- Nearly half of concerned small business owners have been threatened with a lawsuit.

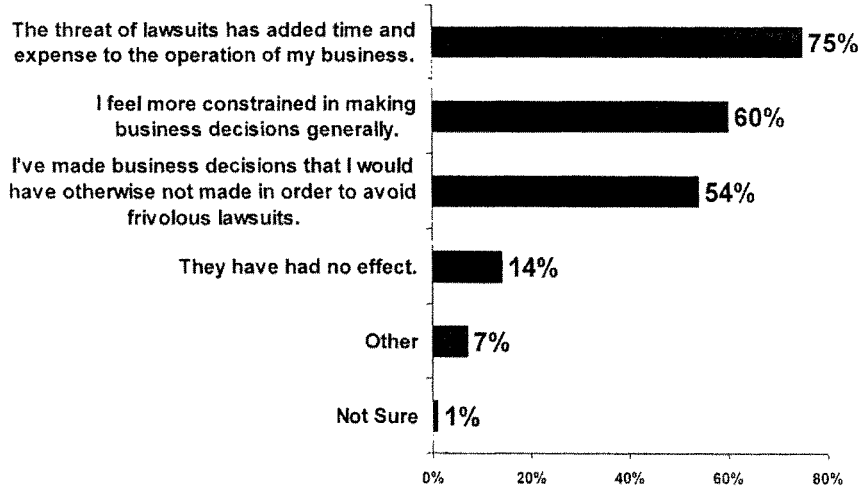


Base: Concerned, Small Business Owners (n = 1109)
Q530 Has anyone actually threatened to bring a lawsuit against the business or you as the person responsible for the business?

Impact of Lawsuit Threats on Business

•Small business owners who have been threatened with a lawsuit cite added time and expense to the operation of the business as having the biggest impact. This is followed by a feeling of general constraint on making business decisions.

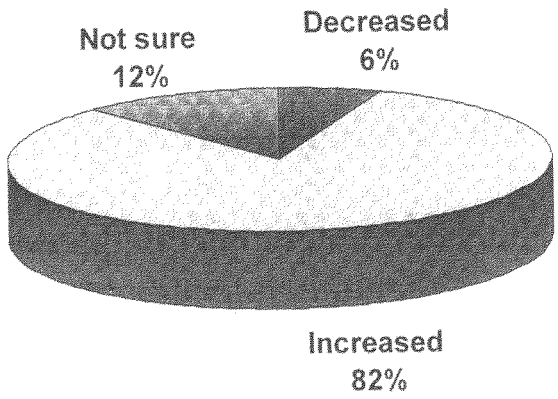
•Only 14% of those who have been threatened say the threats have had no effect.



Base: Yes, Have Been Threatened (n = 409)
Q535: What impact have these threats had on your business?

Trend: Lawsuits and Lawsuit Threats

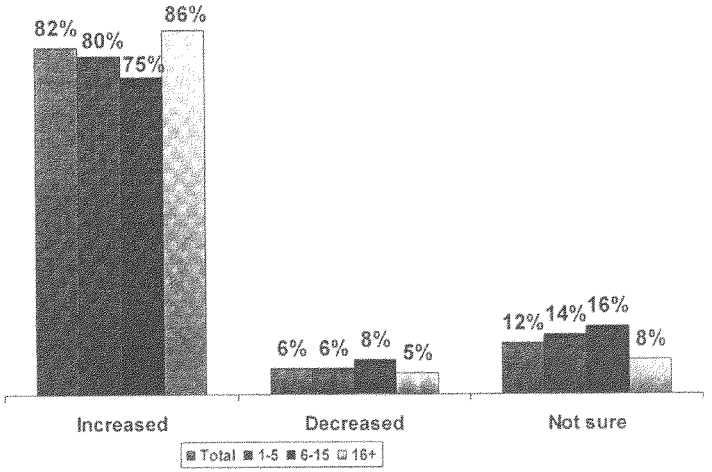
- Eight in ten (82%) believe that lawsuits, or the threat of one, have increased.



Base: Concerned, Small Business Owners (n = 1109)
Q545 In your opinion, have lawsuits, or the threat of lawsuits against small businesses, increased or decreased as a concern generally?

Trend: Lawsuits and Lawsuit Threats (by Employee Size)

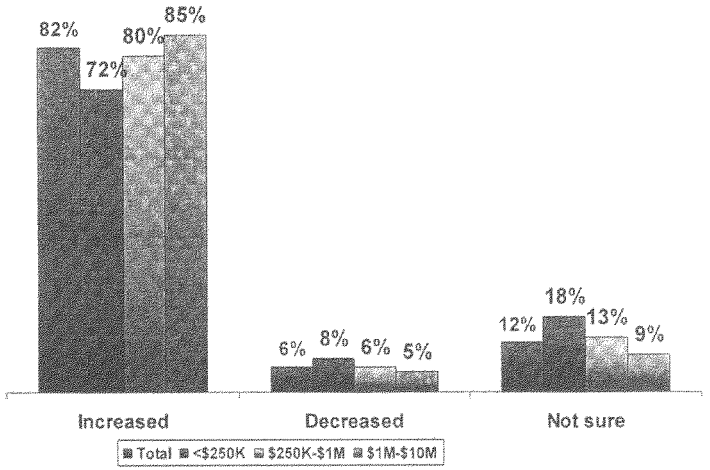
- Larger small companies are more likely to feel the threat of a lawsuit has increased.



Base: Concerned, Small Business Owners (n = 1109)
Q545 In your opinion, have lawsuits, or the threat of lawsuits against small businesses, increased or decreased as a concern generally?

Trend: Lawsuits and Lawsuit Threats by Revenue

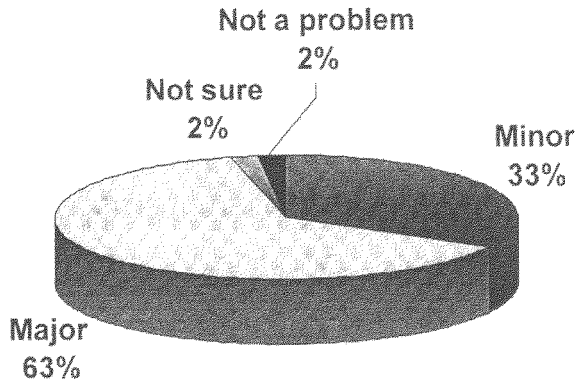
- There is an overall consensus that lawsuits, or the threat of lawsuits, has increased, but small companies with larger revenue are more likely than ones with less to believe the threat has increased.



Base: Concerned, Small Business Owners (n = 1109)
Q545 In your opinion, have lawsuits, or the threat of lawsuits against small businesses, increased or decreased as a concern generally?

Perceived Magnitude of Frivolous/Unfair Lawsuit Problem in Company's State

- **Almost all small business owners (96%) think frivolous/unfair lawsuits are a problem – six in ten (63%) believe they are a major problem.**

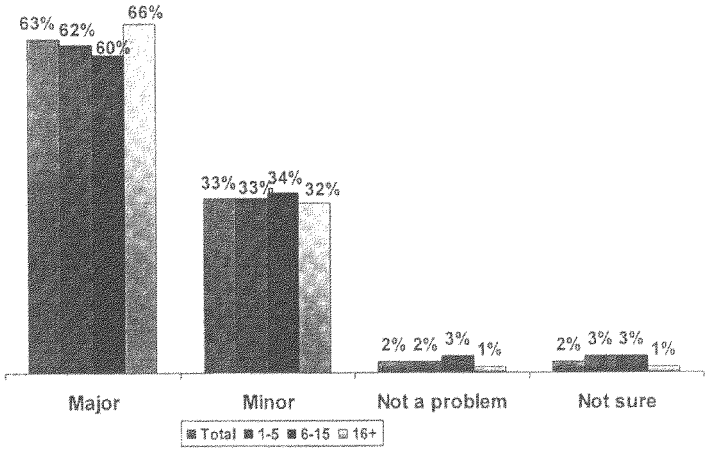


Base: Concerned, Small Business Owners (n = 1109)

Q550 In your state, do you think that frivolous or unfair lawsuits against businesses are a major problem, a minor problem, or not a problem at all?

Perceived Magnitude of Frivolous/Unfair Lawsuit Problem in Company's State (by Employee Size)

- There is no real difference in perception based upon employee size.

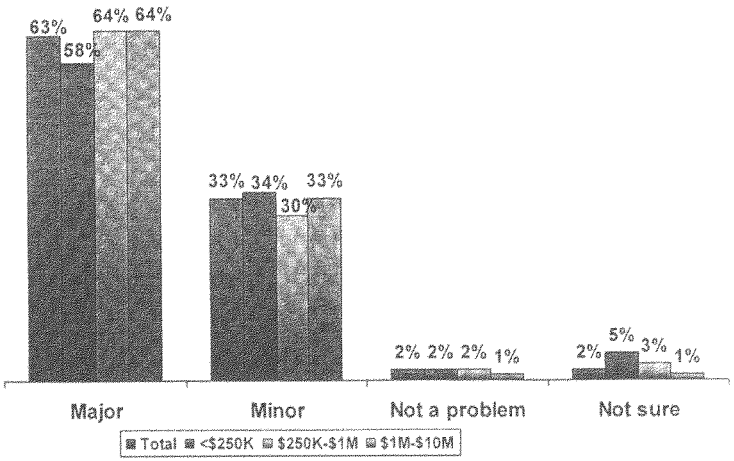


Base: Concerned, Small Business Owners (n = 1109)

Q550 In your state, do you think that frivolous or unfair lawsuits against businesses are a major problem, a minor problem, or not a problem at all?

Perceived Magnitude of Frivolous/Unfair Lawsuit Problem in Company's State (by Revenue)

- Larger small companies are slightly more likely to perceive frivolous/unfair lawsuits as a major problem.

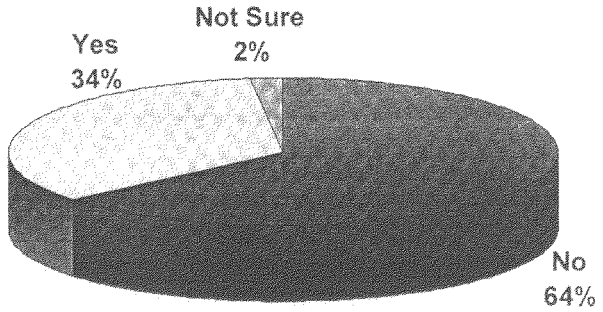


Base: Concerned, Small Business Owners (n = 1109)

Q550 In your state, do you think that frivolous or unfair lawsuits against businesses are a major problem, a minor problem, or not a problem at all?

Whether Company has been sued since 1996

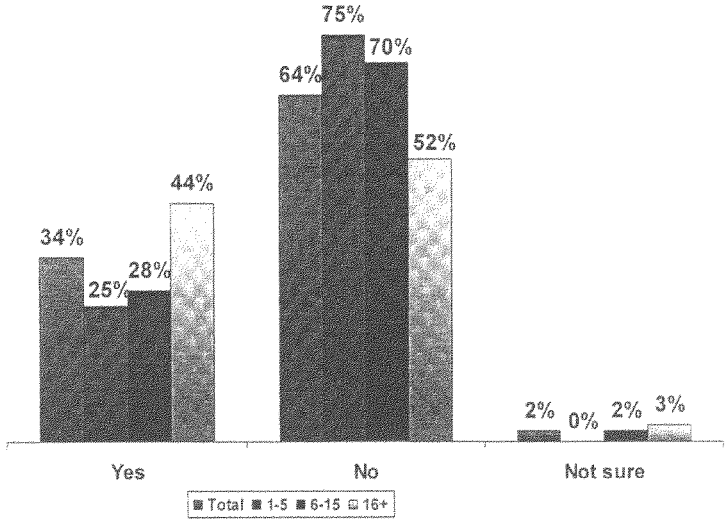
- More than a third of small business owners have been sued themselves, or the company as a whole has been sued, during the past 10 years.



Base: Concerned, Small Business Owners (n = 1109)
Q600 Has your company, or have you or another senior manager as the company's representative, been sued in the past ten years?

Whether Company Has Been Sued (by Employee Size)

- Over two in five companies with 16+ employees (44%) and a quarter of small companies with 1-5 employees have been sued.



Base: Concerned, Small Business Owners (n = 1109)
Q600 Has your company, or have you or another senior manager as the company's representative, been sued?

Most Significant Lawsuit Type

- **The most significant types of lawsuits include: financial loss by a customer resulting from purchase of product or service, personal injury incurred on the company's premises and personal injury resulting from the company's product or service.**

	Total
Base	(276)
	%
Financial loss by a customer resulting from the purchase of a product or service	18
Personal injury incurred on your company's premises	17
Personal injury resulting from your company's product or service	15
Employment dispute with an employee	12
Personal injury resulting from an accident with one of your company's vehicles	10
Financial loss by supplier resulting from a business transaction	5
Some other type	21
Not sure	1

Base: Small Business Owners Who Have Been Sued (n = 276)

Q605 Thinking about the most significant lawsuit, what type of lawsuit was this?

Impact of Lawsuit

- **Almost three quarters (73%) of small businesses have suffered as a result of lengthy litigation, and over six in ten (64%) have suffered because of the high costs.**

	Total
Base	(62)
	%
The litigation was very time consuming and your business suffered as a result.	73
The litigation was very expensive and your business suffered as a result.	64
You feel more constrained in making business decisions generally.	61
You made a business decision or decisions you would not have otherwise made.	54
You have changed business practices in ways that do not really benefit your customers.	45
You have changed business practices in ways that benefit your customers.	35
Some other effect	16
It had no effect on your business	5
Don't know	2

Base: Small Business Owners Who Have Been Sued (n = 276)
Q615 What has been the impact on you or your senior manager as a result of this lawsuit at your company?
Q620 What other effect did the lawsuit have on your company?

Demographic Profile of Small Businesses Surveyed

Employees and Revenue

		%			%
Number of Employees	No employees	--	**Annual Revenue**	Less than $100,000	9
	1 employee	11		$100,000 to less than $250,000	8
	2-5 employees	23		$250,000 to less than $500,000	15
	6-10 employees	14		$500,000 to less than $1 million	14
	11-15 employees	9		$1 million to less than $5 million	34
	16-20 employees	4		$5 million to $10 million	21
	21-50 employees	21		More than $10 million	--
	51 or more employees	18			

Base: Concerned, Small Business Owners (n = 1109)
Q406 And how many employees currently work at your business?
Q407 And would you say that your businesses annual revenue is...

Job Title

	%		%
Executive/Upper Management (Net)	**68**	**Manager (Net)**	**24**
Co-Owner/Partner	6	General Manager	5
President	11	Manager	4
CEO/Chief Executive Officer	4	Office Manager	7
Vice President	2	Business Manager	1
Administrator	3	Other manager mentions	7
Executive Director	1	**Attorney/Lawyer**	--
Controller	1	**Other**	9
Other executive/upper management mentions	4		
Owner *(Subnet)*	**37**		
Owner	30		
Owner/Operator	2		
Owner/President	2		
Owner/Manager	2		
Other owner mentions	2		

Base: Concerned, Small Business Owners (n = 1109)
Q625 What is your job title?

Business Tenure

		%			%
Tenure with Business	1-10 years	43	**Length of owner owning or operating business**	Less than 1 year	1
	11-20 years	26		1 < 3 years	4
	21-30 years	20		3 < 10 years (Net)	21
	31-40 years	7		3 < 5 years	6
	41-50 years	4		5 < 10 years	15
	51-60 years	1		10+ years (Net)	72
	61-70 years	--		10 < 15 years	12
				15 < 20 years	10
Number of Businesses Owned or Operated	1	44		20 years or more	50
	2 – 4 (Net)	37			
	2	18			
	3	13			
	4	6			
	5 or more	15			
	Don't know	2			

Base: Concerned, Small Business Owners (n = 1109)
Q630 How long have you worked with this business?
Q640 How long has the owner owned or operated the business?
Q645 How many businesses have you owned or operated?

STATEMENT
of
DAVID C. WEINER
Past Chair

ABA SECTION OF LITIGATION

and

PETER J. NEESON
Chair

ABA SECTION OF TORT TRIAL AND INSURANCE PRACTICE

on behalf of the

AMERICAN BAR ASSOCIATION

submitted to the

SMALL BUSINESS COMMITTEE

of the

UNITED STATES HOUSE OF REPRESENTATIVES

on the subject of

SMALL BUSINESS AND FEDERAL PRODUCT LIABILITY LEGISLATION

May 24, 2007

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to present the views of the American Bar Association on federal product liability legislation and small businesses. We are David C. Weiner, Past Chair of the ABA's Section of Litigation, and Peter J. Neeson, Chair of the ABA's Section of Tort Trial and Insurance Practice. The Section of Litigation has approximately 77,000 members, many of whom represent clients on both sides of product liability litigation. The Section of Tort Trial and Insurance Practice has approximately 35,000 members who represent plaintiffs, defendants and insurers.

The ABA is committed to having a legal system in America that is effective and just, one that protects the rights of consumers and manufacturers, plaintiffs and defendants. We continually work on many fronts to develop recommendations and pursue projects aimed at improving our civil justice systems at both the federal and state level.

ABA Policy on Federal Product Liability Legislation

The ABA has long opposed enactment of broad federal product liability legislation. We support the continued right of the states and territories to regulate product liability law rather than having the United States Congress mandate federal legislation. We have adopted an extensive set of recommendations aimed at improving the tort liability systems at the state level. It is attached as Appendix A. The ABA opposes broad federal product liability such as the proposed "Small Business Liability Reform Act," which was introduced in the 108th Congress as H.R. 2813. The ABA also opposes legislation which would limit a product seller's liability for the sale of a defective product such as the proposed "Innocent Sellers Fairness Act," which was introduced in the 109th Congress as H.R. 5500. We understand these bills will be reintroduced in this Congress.

ABA Rationale for Opposition to Broad Federal Product Liability Legislation

The ABA opposes legislation such as H.R. 2813 because we believe broad federal product liability legislation would deprive consumers of the sound guidance of the well-developed product liability laws of their

individual states, as well as the flexibility to refine carefully the law through their state courts, and to make any necessary major improvements in the law through their state legislatures. Today our citizens have available, for the peaceful resolution of disputes, a system of law based on over 200 years of careful analysis of judicial precedent drawn from cases in their own communities of similar factual premise.

Due to alternative forums and the rich diversity of social environment in a huge country, the judiciary of our states has before it a wealth of past legal experience with which to guide deliberations for the fair and just resolution of disputes. The result is a flexible, constantly developing body of law which balances the conflicting needs and demands of the present day as reflected in current disputes. A legal system which results in that balance should not be disturbed by Congress on the pretext of restoring another perception of balance pressured by one special interest group or another. Otherwise, Congress will have effectively rejected a legal system which, after two centuries, continues to demonstrate that it is the best method by which to maintain the confidence in the judicial system of the country by the public as a whole.

Federal legislation such as H.R. 2813 would be an unwise and unnecessary intrusion of massive proportions on the long-standing authority of states to promulgate tort law and, rather than resolve whatever uncertainties now exist, would result in legal chaos. Such legislation would create a federal over-lay on top of the judicial system of the fifty States. This would create endless issues of interpretation and dispute, all of which would needlessly drive up the cost and extend the time to resolve a dispute. Our citizens will be badly served by this additional complexity at a time when the ABA, and other groups representing broad constituencies, are working to drive down the cost and delay inherent in litigation, while at the same time keeping the doors of the courthouse open.

Further, constitutional challenges to such an act, in whole or part, would be raised in the various state courts where jurisdiction would reside under H.R. 2813. Interpretation of various provisions of H.R. 2813 would differ as state courts tailor their decisions according to the situation in their individual states. This would be compounded by the fact that there is no body of law, other than a state's own, to aid state courts in applying a

federal standard to any given set of facts. In addition, unequal results would occur when product liability litigation is combined with other fields of law with differing rules of law, for example, when a product liability claim is joined with an automobile liability claim.

There is no evidence that the number of tort cases is increasing. In fact, tort filings have decreased over the years according to the National Center for State Courts. In 1996, it reported that "[a]lthough tort reform continues to be hotly debated in Congress and in many state legislatures, there is no evidence that the number of tort cases is increasing. In fact, tort filings decreased 9 percent from 1990 to 1993 and have remained stable for the past two years [1994 and 1995]. All states have enacted some type of tort reform in the past decade, though the impact of these reforms is clearer in some states than in others." See *Examining the Work of State Courts, 1995, a National Perspective from the Court Statistics Project,"* Brian J. Ostrom and Neal B. Kauder for the National Center for State Courts, 1996, p. 7. In 2006, it reported that the number of cases was lower in 2004 than it was in 1995. These statistics are the latest statistics available. See *Examining the Work of State Courts, 2005, a National Perspective from the Court Statistics Project*," R. Schauffler, R. LaFountain, S. Strickland and W. Raftery for the National Center for State Courts, 2006, p. 27.

Likewise, the number of tort cases has also fallen at the federal level. The most recent statistics from the Federal Justice Statistics Program found that the number of tort trials concluded in U.S. district courts declined by 79 percent - from 3,600 trials in 1985 to fewer than 800 trials in 2003. Approximately nine out of 10 tort trials involved personal injury issues - most frequently, product liability, motor vehicle (accident), marine and medical malpractice cases. The percentage of tort cases concluded by trial in U.S. district courts has also declined from 10 percent in the early 1970s to 2 percent in 2003. See *Federal Tort Trials and Verdicts*, 2002-03, Thomas H. Cohen, J.D., Ph.D., Bureau of Justice Statistics, August 2005, p. 1 and p. 3.

ABA Policy on Narrowly Drawn Federal Legislation

The ABA supports enactment of narrowly drawn federal legislation on

compensation which addresses the issues of liability and damages with respect to claims arising out of occupational diseases (such as asbestosis) with long latency periods in cases where: 1) the number of such claims and the liability for such damages threaten the solvency of a significant number of manufacturers engaged in commerce; and 2) the number of such claims has become an excessive burden on the judicial system. The ABA also supports federal legislation allocating product liability risks between the federal government and its contractors.

Discussion of Product Seller Provisions of H.R. 2813 of the 108th Congress and H.R. 5500 of the 109th Congress

The ABA opposes the product seller provisions of H.R. 2813 because those provisions remove the motivation of the only party with direct contact with the consumer, the seller, to ensure that the shelves in American businesses are stocked only with safe products. Seller liability is an effective way of maintaining and improving product safety. Manufacturers traditionally rely on sellers to market their products. Through their purchasing and marketing power, sellers have influenced manufacturers to design and produce safer consumer goods.

Ambiguity in the language of these bills may result in unintentionally eliminating grounds for liability which promote safety. For example, the bills expressly eliminate a product seller's liability for breach of warranty except for breach of express warranties. The Uniform Commercial Code, long regarded as a reasonable, balanced law, holds sellers responsible for breach of implied warranties as well. By its vague and ambiguous language, the proposed legislation may result in preempting these long-established grounds of liability.

Method of Developing ABA Policy on Broad Federal Product Liability Legislation

ABA policy opposing enactment of broad federal product liability legislation is based on February 1983 recommendations developed by a diverse committee charged by the ABA to study the advisability of broad federal product liability legislation. That entity reaffirmed and expanded on 1981 ABA policy. That committee was appointed by the ABA President in

1982 and was named the Special Committee to Study Product Liability. The Committee included among its members nominees of the Sections of Business Law, Public Contract Law, Litigation and Tort and Insurance Practice and was chaired by a law school dean. Based on the recommendations and report of the Special Committee, in February 1983, the ABA's House of Delegates adopted the resolution appended to this statement as Appendix B.

On February 14, 1995, the ABA's House of Delegates reaffirmed its opposition to such legislation adopting the following policy:

> Resolved that the American Bar Association supports the continued right of the states and territories to regulate product liability law and it is further resolved that the American Bar Association opposes federal legislation abolishing strict seller liability and opposes the product seller provision set forth in section 103(b) of H.R. 10.

ABA Recommendations for Improving the State Tort Liability Systems

ABA policy aimed at improving the tort liability system at the state level was developed by a broadly-based entity appointed by the ABA President in 1985. The 14-member commission was called the Action Commission to Improve the Tort Liability System.

The members of the Commission were federal trial and appellate court judges; a state Supreme Court justice; corporate counsel, including those with insurance experience; consumer and civil rights advocates; academicians; and practicing plaintiff and defense lawyers.

In February 1987, the ABA House of Delegates considered the Commission's recommendations and adopted the resolution appended to this statement as Appendix A.

Many state legislatures and state judicial systems have implemented these or similar recommendations to those recommended by the ABA in 1987. For states that have not done so, we believe that these

recommendations to improve the tort system can and should be implemented by the courts and legislatures at the state, and not the federal, level. While not perfect, the tort systems throughout this country are working well.

This is in keeping with the ABA's view that the tradition of state-fashioned tort principles remains fundamentally sound.

The 1987 ABA resolution makes numerous recommendations addressed to the courts and to the lawyers. These recommendations include the following:

1. No ceilings should be placed on pain and suffering awards. Instead, trial and appellate courts should more effectively control pain and suffering verdicts which are either so excessive or so inadequate as to be disproportionate to the injury suffered or to community expectations.

2. Tort awards for pain and suffering should be more uniform. To achieve that goal, the ABA recommends such approaches as objective annual studies of tort awards, public information on those awards, guidelines for use by the trial courts, and study given as to whether additional guidance can and should be given to the jury on the range of appropriate damage awards.

3. Fee arrangements should be written in plain English or appropriate other language; percentage fees should be out of the net amount and not out of the gross amount of any judgment or settlement; and courts or a public body should disallow attorneys fees that are found to be plainly excessive.

4. To protect future claimants, the ABA opposes various forms of secrecy agreements and arrangements that require destruction of information or records as well as agreements that would prohibit a particular attorney from representing other claimants.

5. The ABA has specific recommendations addressed to the courts to streamline the litigation process, to eliminate frivolous

claims and to reduce the long delays currently characteristic of much litigation. These include permitting non-unanimous jury verdicts and use of alternative dispute resolution methods.

There are certain areas in which the ABA believes state legislative action may be needed.

1. The ABA believes that punitive damages are appropriate in certain cases, but their scope should be limited. They should not be commonplace. The basic standard to establish punitive damages should be a conscious or deliberate disregard of a defendant's obligations. The standard of proof should be "clear and convincing" evidence and not a lesser standard such as a "preponderance of the evidence."

2. The ABA is concerned that no defendant should be subjected to punitive damages that are excessive in the aggregate for the same wrongful act. There should therefore be safeguards to prevent the imposition of repeated punitive damages. The purpose of punitive damages is to punish, not to confiscate. The ABA recognizes that the principal responsibility to control excessive awards for punitive damages rests on the courts; however, state legislation may be necessary to assure more effective judicial review of punitive damage awards.

3. The ABA believes that the doctrine of joint and several liability should be limited by legislation to apply only to economic losses in certain cases. Defendants should not be held liable for someone else's share of any non-economic loss when the defendant's responsibility is substantially disproportionate to liability for the entire loss suffered by the plaintiff.

4. The ABA recognizes that allowing non-unanimous jury verdicts may require legislation.

The ABA distributed these recommendations widely. For example, in 1992 the ABA released the *ABA Blueprint for Improving the Civil Justice System* setting forth these and many other ABA recommendations for

improving the fairness, efficiency and effectiveness of the civil justice system. Nearly 5,000 copies of the *Blueprint* have been distributed to legislative and court officials, state and local bar officials, numerous other professional groups, the chairs of all ABA sections and committees; and key journalists. Numerous requests have been received from lawyers, judges, reporters, academicians, law students and the public. I was a member of the ABA entity that developed the *Blueprint*. A chapter highlighting these recommendations was also included in *An Agenda for Justice: ABA Perspectives on Criminal and Civil Justice Issues* that was released in August 1996. The Agenda -- developed by the Ad Hoc Committee on Civil Justice Improvements and the Ad Hoc Committee on Criminal Justice Improvements in conjunction with the ABA's Justice Initiatives program -- was the ABA's first comprehensive and descriptive compilation of recommendations for justice system improvements. Almost 5,000 copies have been distributed in a manner similar to that of the *Blueprint*. I was a member of the Ad Hoc Committee for Civil Justice Improvements when it developed the *Agenda*.

The Coalition for Justice

Lawyers, individually and as members of the organized bar, have long worked with judges and other officials to improve the justice system.

For a number of years, the ABA and numerous state and local bar associations have been working primarily through the ABA's Coalition for Justice to form partnerships with members of the public and community groups so that we can take a fresh look at the problems of the civil and criminal justice systems. The Coalition for Justice helps to coordinate the ABA Justice Initiatives Programs, encouraging access, raising public awareness and developing public/bar partnerships with national organizations and federal agencies on justice system issues. Coalition members include not only bar leaders, but also officials from public interest, business, government, media and senior citizens organizations.

The Coalition's goal is to help restore public confidence in the justice system by developing a broad-based network of organizations that will support and participate in justice system improvements at the state and local level. The outreach efforts of the Coalition have resulted in

partnerships with groups such as the American Association of Retired Persons, League of Women Voters, NAACP and others.

Justice initiatives have included citizen's conferences, the establishment of justice commissions in over two hundred jurisdictions, preparation of National Issues Forums to educate community groups, "hot topics" programs, and a variety of other approaches on access to justice or civil and criminal justice improvements.

Thank you for giving me this opportunity to submit the American Bar Association's views to you on this important subject.

APPENDIX A

RESOLUTION APPROVED
AMERICAN BAR ASSOCIATION
HOUSE OF DELEGATES

February 16-17, 1987
(Report No. 123)

Be It Resolved, That the American Bar Association adopts the following recommendations:

A. Insurance

1. The American Bar Association should establish a commission to study and recommend ways to improve the liability insurance system as it affects the tort system.

B. Pain and Suffering Damages

2. There should be no ceilings on pain and suffering damages, but instead trial and appellate courts should make greater use of the power of remittitur or additur with reference to verdicts which are either so excessive or inadequate as to be clearly disproportionate to community expectations by setting aside such verdicts unless the affected parties agree to the modification.

3. One or more tort award commissions should be established, which would be empowered to review tort awards during the preceding year, publish information on trends, and suggest guidelines for future trial court reference.

4. Options should be explored by appropriate ABA entities whether additional guidance can and should be given to the jury on the range of damages to be awarded for pain and suffering in a particular case.

C. Punitive Damages

5. Punitive damages have a place in appropriate cases and therefore should not be abolished. However, the scope of punitive damages should be narrowed through the following measures:

a. Standards of Conduct and Proof

Punitive damages should be limited to cases warranting special sanctions and should not be commonplace. A threshold requirement for the submission of a punitive damages case to the finder of fact should be that the defendant demonstrated a conscious or deliberate disregard with respect to the plaintiff. As a further safeguard, the standard of proof to be applied should be "clear and convincing" evidence

as opposed to any lesser standard such as "by a preponderance of the evidence."

b. The Process of Decision

(1) Pre-Trial - Appropriate pre-trial procedures should be routinely utilized to eliminate frivolous claims for punitive damages prior to trial, with a savings mechanism available for late discovery of misconduct meeting the standard of liability.

(2) Trial - Evidence of net worth and other evidence relevant only to the question of punitive damages ordinarily should be introduced only after the defendant's liability for compensatory damages and the amount of those damages have been determined.

(3) Post-Trial - As a check against excessive punitive damage awards, verdicts including such awards should be subjected to close scrutiny by the courts. The trial court should order remittitur wherever justified. Excessiveness should be evaluated in light of the degree of reprehensibility of the defendant's acts, the risk undertaken by the plaintiff, the actual injury caused, the net worth of the defendant, whether the defendant has reformed its conduct and the degree of departure from typical ratios (as reflected in the best available empirical data) between compensatory and punitive damages. If necessary to assure such judicial review, appropriate legislation should be enacted. Opinions issued by trial or appellate courts either upholding or modifying an award should specify the factors which were considered and relied upon.

c. Multiple Judgment Torts

While the total amount of any punitive damages awarded should be adequate to accomplish the purposes of punitive damages, appropriate safeguards should be put in force to prevent any defendant from being subjected to punitive damages that are excessive in the aggregate for the same wrongful act.

d. Vicarious Liability

With respect to vicarious liability for punitive damages, the provisions of Section 909 of the Restatement (Second) of Torts (1979) should apply. Legislatures and courts should be sensitive to adopting appropriate safeguards to protect the master or principal from vicarious liability for the unauthorized acts of nonmanagerial servants or agents.

e. To Whom Awards Should Be Paid

In certain punitive damages cases, such as torts involving possible multiple judgments against the same defendant, a court could be authorized to determine what is a reasonable portion of the punitive damages award to compensate the plaintiff and counsel for bringing the action and prosecuting the punitive damage claim, with the balance of the award to be allocated to public purposes, which could involve methods of dealing with multiple tort claims such as consolidation of claims or forms of class actions. The novelty of such proposals and the absence of any adequately tested programs for implementing require further study before an informed judgment can be made as to whether, or to what extent, such proposals will work in practice. We urge such studies. The concept of public allocation of portions of punitive damage awards in single judgment actions is also worthy of consideration to the extent workable methods of implementation may hereafter be developed.

D. Joint-and-Several Liability

6. The doctrine of joint-and-several liability should be modified to recognize that defendants whose responsibility is substantially disproportionate to liability for the entire loss suffered by the plaintiff are to be held liable for only their equitable share of the plaintiff's noneconomic loss, while remaining liable for the plaintiff's full economic loss. A defendant's responsibility should be regarded as "substantially disproportionate" when it is significantly less than any of the other defendants; for example, when one of two defendants is determined to be less than 25% responsible for the plaintiff's injury.

E. Attorneys' Fees

7. Fee arrangements with each party in tort cases should be set forth in a written agreement that clearly identifies the basis on which the fee is to be calculated. In addition, because many plaintiffs may not be familiar with the various ways that contingency fees may be calculated, there should be a requirement that the contingency fee information form be given to each plaintiff before a contingency fee agreement is signed. The content of the information form should be specified in each jurisdiction and should include at least the maximum fee percentage, if any, in the jurisdiction, the option of using different fee percentages depending on the amount of work the attorney has done in obtaining a recovery, and the option of using fee percentages that decrease as the size of a recovery increases. The form should be written in plain English, and, where appropriate, other languages.

8. Courts should discourage the practice of taking a percentage fee out of the gross amount of any judgment or

settlement. Contingent fees should normally be based only on the net amount recovered after litigation disbursements such as filing fees, deposition costs, trial transcripts, travel, expert witness fees, and other expenses necessary to conduct the litigation.

9. Upon complaint of a person who has retained counsel, or who is required to pay counsel fees, the fee arrangement and the fee amount billed may be submitted to the court or other appropriate public body, which should have the authority to disallow, after a hearing, any portion of a fee found to be "plainly excessive" in light of prevailing rates and practices.

F. Secrecy and Coercive Agreements

10. Where information obtained under secrecy agreements (a) indicates risk of hazards to other persons, or (b) reveals evidence relevant to claims based on such hazards, courts should ordinarily permit disclosure of such information, after hearing, to other plaintiffs or to government agencies who agree to be bound by appropriate agreements or court orders to protect the confidentiality of trade secrets and sensitive proprietary information.

11. No protective order should contain any provision that requires an attorney for a plaintiff in a tort action to destroy information or records furnished pursuant to such order, including the attorney's notes and other work product, unless the attorney for a plaintiff refuses to agree to be bound by the order after the case has been concluded. An attorney for plaintiff should only be required to return copies of documents obtained from the defendant on condition that defendant agrees not to destroy any such documents so that they will be available, under appropriate circumstances, to government agencies or to other litigants in future cases.

12. Any provision in a settlement or other agreement that prohibits an attorney from representing any other claimant in a similar action against the defendant should be void and of no effect. An attorney should not be permitted to sign such an agreement or request another attorney to do so.

G. Streamlining the Litigation Process: Frivolous Claims and Unnecessary Delay

13. A "fast track" system should be adopted for the trial of tort cases. In recommending such a system, we endorse a policy of active judicial management of the pre-trial phases of tort litigation. We anticipate a system that sets up a rigorous pre-trial schedule with a series of deadlines intended to ensure that tort cases are ready to be placed on the trial calendar within a specified time after filing and tried promptly thereafter. The courts should enforce a firm policy against continuances.

14. Steps should be taken by the courts of the various states to adopt procedures for the control and limitation of the scope and duration of discovery in tort cases. The courts should consider, among other initiatives:

(a) At an early scheduling conference, limiting the number of interrogatories any party may serve, and establishing the number and time of depositions according to a firm schedule. Additional discovery could be allowed upon a showing of good cause.

(b) When appropriate, sanctioning attorneys and other persons for abuse of discovery procedures.

15. Standards should be adopted substantially similar to those set forth in Rule 11 of the Federal Rules of Civil Procedure as a means of discouraging dilatory motions practice and frivolous claims and defenses.

16. Trial judges should carefully examine, on a case-by-case basis, whether liability and damage issues can or should be tried separately.

17. Nonunanimous jury verdicts should be permitted in tort cases, such as verdicts by five of six or ten of twelve jurors.

18. Use of the various alternative dispute resolution mechanisms should be encouraged by federal and state legislatures, by federal and state courts, and by all parties who are likely to, or do become involved in tort disputes with others.

H. Injury Prevention/Reduction

19. Attention should be paid to the disciplining of all licensed professionals through the following measures:

(a) A commitment to impose discipline, where warranted, and funding of full-time staff for disciplinary authorities. Discipline of lawyers should continue to be the responsibility of the highest judicial authority in each state in order to safeguard the rights of all citizens.

(b) In every case in which a claim of negligence or other wrongful conduct is made against a licensed professional, relating to his or her profession, and a judgment for the plaintiff is entered or a settlement paid to an injured person, the insurance carrier, or in the absence of a carrier, the plaintiff's attorney, should report the fact and the amount of payment to the licensing authority. Any agreement to withhold such information and/or to close the files from the disciplinary authorities should be unenforceable as contrary to public policy.

I. Mass Tort

20. The American Bar Association should establish a commission as soon as feasible, including members with expertise in tort law, insurance, environmental policy, civil procedure, and regulatory design, to undertake a comprehensive study of the mass tort problem with the goal of offering a set of concrete proposals for dealing in a fair and efficient manner with these cases.

J. Concluding Recommendation

21. After publication of the report, the ABA Action Commission to Improve the Tort Liability System should be discharged of its assignment.

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APPENDIX B

RESOLUTION OF THE HOUSE OF DELEGATES

OF THE AMERICAN BAR ASSOCIATION

ADOPTED FEBRUARY, 1983

I. BE IT RESOLVED, That the American Bar Association opposes enactment of broad federal legislation that would codify the tort laws of the 50 states as they relate to product liability, and opposes legislation, such as S.2631 reported by the Senate Commerce, Science and Transportation Committee in the 97th Congress, that would attempt to do so.

II. FURTHER RESOLVED, That the American Bar Association supports federal legislation which addresses the issues of liability and damages with respect to claims for damages against manufacturers by those who contract an occupational disease (such as asbestosis) when: (a) there is a long latency period between exposure to the product and manifestation of the disease; (b) the number of such claims and the liability for such damages in fact threaten the solvency of a significant number of manufacturers engaged in interstate commerce; and (c) the number of such claims have become clearly excessive burdens upon the state and federal judicial systems.

III. FURTHER RESOLVED, That the American Bar Association supports enactment of federal legislation allocating product liability risks between the federal government and its contractors and providing, in certain instances, indemnity against those risks.

AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

815 SIXTEENTH STREET, N.W.
WASHINGTON, D.C. 20006

JOHN J. SWEENEY
PRESIDENT

RICHARD L. TRUMKA
SECRETARY-TREASURER

LINDA CHAVEZ-THOMPSON
EXECUTIVE VICE-PRESIDENT

LEGISLATIVE ALERT!

(202) 637-5090

May 17, 2007

Honorable Nydia Velasquez, Chairwoman
House Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C. 20515

Ranking Minority Member Steve Chabot
House Committee on Small Business
2361 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairwoman Velasquez and Ranking Minority Member Chabot:

We are writing to express our concerns about liability reform legislation that will be the subject of a hearing in the Committee on Small Business, Thursday, May 17.

The AFL-CIO strongly opposes legislation that would limit the statute of repose on durable goods, such as H.R. 3509, The Workplace Goods Jobs Growth and Competitiveness Act of 2005. We also continue to oppose any measures that would federalize the tort system in order to protect the manufacturers of defective products, and prevent workers in particular from recovering for their on-the-job injuries.

Bills such as H.R. 3509, considered during the 109th Congress, would grossly discriminate against workers, barring them from recovery in state courts, while permitting bystanders or employers to sue manufacturers of defective products in similar situations. Hazardous equipment and machinery are a major cause of worker death and injury. In 2004 hazardous machinery and equipment were responsible for nearly 1,000 workplace deaths and more than 112,000 serious workplace injuries, according to the Bureau of Labor Statistics.

Instead of holding the manufacturers responsible for defects in their products, H.R. 3509 would transfer the liability for defective durable goods on to the backs of workers and their employers. It limits recovery for workers injured on the job to state workers' compensation programs which, according to a 2004 report by the National Academy of Social Insurance, paid benefits for severe on-the-job injuries that were below the poverty level in 16 states. Bills like H.R. 3509 would prevent injured workers and their survivors from seeking any redress from products manufacturers for their injuries by imposing an arbitrary deadline, leaving many of them impoverished.

We urge the committee to oppose legislation similar to H.R. 3509, and ask that this letter be included in the hearing record of May 17, 2007.

Sincerely,

William Samuel, Director
DEPARTMENT OF LEGISLATION

c: All members of the House Committee on the Small Business Committee

WRITTEN STATEMENT
OF

SHERMAN JOYCE, PRESIDENT
AMERICAN TORT REFORM ASSOCIATION
WASHINGTON, D.C.

SUBMITTED TO THE

COMMITTEE ON SMALL BUSINESS

UNITED STATES HOUSE OF REPRESENTATIVES

REGARDING:
"LIABILITY REFORM AND SMALL BUSINESS"

ON

MAY 17, 2007

Introduction

This statement is being submitted to the House Committee on Small Business on behalf of the American Tort Reform Association (ATRA) in regards to the hearing, "Liability Reform and Small Business," being held on May 17, 2007.

ATRA is a Washington, D.C.-based membership association of more than 300 large and small businesses, physician groups, nonprofits, and trade and professional associations having as its mission the establishment of a predictable, fair, and efficient civil justice system through the enactment of legislation and public education.

Overview of Problem

One of the biggest fears of a small business owner is receiving a notification of a lawsuit.[1] These suits often cost tens of thousands of dollars to defend, even when claims are frivolous or specious, and can result in financial and emotional ruin for the hardworking men and women trying to live the American dream. Unfortunately, this is exactly what is occurring right now in our own backyard of Washington, D.C., where a much publicized $65 million lawsuit is pending in D.C. Circuit Court against Custom Cleaners, a North East Washington dry cleaning establishment, over a lost pair of pants valued at $150.[2] The plaintiff, D.C. Administrative Law Judge Roy Pearson Jr., sued Custom Cleaners, owned by the Chung family who are Korean immigrants, under the District of Columbia's consumer protection statute. Pearson has continued to pursue litigation despite a generous offer by the Chung's to settle the claim for $12,000,[3] and widespread public condemnation and outrage.[4] A recent newspaper item indicates that

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[1] According to one survey, close to half (47 percent) of small business owners are somewhat or very concerned that they will be defendants in a liability suit in the next few years. *See National Small Business Poll: Liability, Volume 2, Issue 2*, NATIONAL FEDERATION OF INDEPENDENT BUSINESS (2002).

[2] The lawsuit *Pearson* v. *Chung*, Civ. Action No. 4302-05 (D.C. Super.), has received extensive national and international media coverage. The initial story about the case appeared in a column by Marc Fisher. *See* Marc Fisher, *Lawyer's Price For Missing Pants: $65 Million*, THE WASHINGTON POST, Apr. 26, 2007, at B1.

[3] *Id*

[4] *See* Editorial, *Kick in the Pants*, THE WASHINGTON POST, May 3, 2007, at A24.

Pearson believes the damages sought are justified because of signs posted in the dry cleaning establishment that promised "Satisfaction Guaranteed" and "Same Day Service" and that failure to provide such services constitute violations of the District's consumer protection law.[5] Never mind that this lawsuit is absurd on its face, the claim illustrates how poorly constructed state consumer protection statutes are being seized upon by plaintiffs to target, harass, and often extort settlements from virtually defenseless small business owners, even when the claim is as outrageous as asking for $65 million for a lost pair of pants.

Unlike large corporations that have dedicated legal departments and scores of outside lawyers on retainer, small businesses all too often do not have the resources or wherewithal to defend themselves against frivolous, predatory, and unmeritorious lawsuits. The scourge of lawsuit abuse harms the very engine that drives America's economy. According to a study commissioned by the U.S. Chamber of Commerce's Institute for Legal Reform and the economic consulting firm NERA, small business owners bear 68 percent of the $129 billion annual costs the tort system imposes on business; yet, small business only takes in 25 percent of business revenue.[6]

The economic costs along with the emotional toll are more than most small business owners can bear. Two problems in particular plague small business: frivolous lawsuits and abusive consumer protection claims.

Frivolous Lawsuits

It costs little more than a small filing fee and often takes little more time than generating a form complaint to begin a lawsuit. It costs much more for a small business to defend against it. The system is rigged to allow, in effect, legal extortion. ATRA's General Counsel Victor Schwartz accurately describes the problem of frivolous lawsuits against small business as "Death by a Thousand

[5] *See* Marc Fisher, *Judge in $65 Million Suit Might Keep Seat on Bench*, THE WASHINGTON POST, May 10, 2007, at B01.
[6] *See* INSTITUTE FOR LEGAL REFORM / NERA, TORT LIABILITY COSTS FOR SMALL BUSINESS (2004).

Cuts."[7] Too often a plaintiff's lawyer will file a frivolous lawsuit that has no basis in law or fact and seek damages with the knowledge that the amount sought is less than what it would cost for the small business's insurance company to defend through litigation. In the end, the insurance company settles, and the small business sees an increase in their liability premiums. Unfortunately, the weaponry to fight frivolous claims and ward off these predatory lawsuits was weakened considerably when Federal Rule of Civil Procedure 11 was changed in 1993.[8] These changes made Rule 11 toothless by:

- Allowing judges to refuse to sanction a violating lawyer;
- Substantially reducing the likelihood that a sanction would force plaintiffs' lawyers to pay a defendant's needless legal expenses engendered by the frivolous claim; and
- Providing a 21-day "safe harbor" that gives the plaintiff a free pass to withdraw frivolous pleadings without sanction. The plaintiff's lawyer can simply change the words of the pleading, file it again, and so it goes on.

Due to the weakening of Rule 11, there are no substantial deterrents to filing frivolous claims, and the 21-day safe harbor practically invites these claims to be filed. It is clear that Rule 11 must be strengthened to discourage plaintiffs' lawyers from victimizing our nation's small business owners. Fortunately, a proposal already exists that would deal with this problem, the *Lawsuit Abuse Reduction Act* (LARA). This proposal, in the form of H.R. 4571, passed the House of Representatives in 2004 by a vote of 229-174 and passed the House again in 2005, in the form of H.R. 420, by a vote of 228-184. These bills had, and the concept still has, the support of major organizations and businesses of all sizes, including ATRA, the National Association of Manufacturers, National

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[7] *See Safeguarding Americans from a Legal Culture of Fear: Approaches to Limiting Lawsuit Abuse Before the House Judiciary Committee* (June 22, 2004) (statement of Victor E. Schwartz, ATRA General Counsel).

[8] *Amendments to Federal Rules of Civil Procedure and Forms*, 146 F.R.D. 401 (1993).

Federation of Independent Business, National Restaurant Association, National Association of Wholesaler-Distributors, and the U.S. Chamber of Commerce. The main elements of the LARA proposal to rein in frivolous claims include provisions that:

- Restore mandatory sanctions on attorneys, law firms, or parties who file frivolous lawsuits;
- Abolish the "safe harbor" provision that allows parties and their attorneys to avoid sanctions by withdrawing a suit within 21 days after a motion for sanctions has been filed;
- Permit monetary sanctions, including reimbursement of reasonable attorney's fees and litigation costs in connection with frivolous lawsuits; and
- Restore the opportunity for sanctions for abuses of the discovery process.

Congress should act to protect small businesses and provide the necessary weaponry to fight frivolous lawsuits. Without changes to Rule 11, small business owners will continue to fall prey to extortionate lawsuits that hamper economic growth and hurt the very productive segments of society that provide jobs and innovation in our great country.

Abusive Consumer Protection Claims[9]

The pants lawsuit against the Chungs is a classic illustration of how small business is victimized by abusive litigation tactics through the utilization of consumer protection laws. Roy Pearson arrived at the $65 million in requested damages in part by using a provision in the D.C. code that provides for $1,500 per violation of the consumer protection law and multiplied that amount by the number of days the "misleading" signs were posted in the dry cleaners. In

[9] The American Tort Reform Foundation published a white paper on the problems with state consumer protection laws. *See* The American Tort Reform Foundation, Private Consumer Protection Lawsuit Abuse: When Claims Are Driven By Profit-driven Lawyers And Interest Group Agendas, Not The Benefit of Consumers, available at http://www.atra.org/reports/consumers/consumer_protection.pdf.

addition, Pearson unsuccessfully tried to have the case brought as a class action on behalf of all customers of Custom Cleaners. The fact that Pearson, though misguided, could logically derive a number as high as $65 million shows how poorly constructed our nation's consumer protection laws are and how vulnerable small business is to abuse. Even though observers ultimately expect the defendants to prevail in the dry cleaners case, the Chungs have wracked up enormous legal expenses and have contemplated moving back to Korea because of their experience with American "justice."

Unfortunately, the District is not the only place where small business has been victimized by consumer protection laws. Notably, in California, small businesses were easy prey for personal injury lawyers who used the plaintiff-friendly provisions of the state's Unfair Competition Law (UCL), section 17200 of the Business and Profession code, to in essence legally extort settlements from small business through fear of litigation. Until the UCL was reformed by ballot measure in 2004, plaintiff's lawyers were able to bring claims without having to allege an injury or loss and, incredibly, without even having to have a client! Small business owners who ran establishments, such as nail salons, auto-body shops, and restaurants, were often victims of shakedown UCL claims brought by personal injury lawyers for technical violations, such as running newspaper ads that printed "APR" instead of "annual percentage rate" and using the same container of nail polish on more than one client.[10] Typically, personal injury lawyers would send a letter notifying the "offending" small business that a lawsuit was forthcoming, but that litigation could be avoided by payment of a few thousand dollars directly to the personal injury lawyer. This is exactly what happened when a Beverly Hills plaintiff's firm sent 2,200 claims against restaurants and auto repair shops on behalf of a front corporation located in Santa Ana.[11] The claims were based on technical violations of the state's Automotive Repair Act, and the firm generously sent defendants settlement

[10] Amanda Bronstad, *Nail Salons Sued Under Unfair Competition Law*, L.A. BUS. J., Dec. 16, 2002, at 12.
[11] Monte Morin, *State Accuses Law Firm of Extortion*, L.A. TIMES, Feb. 27, 2003, at 5.

offers that demanded payment ranging from $6,000 to $26,000.[12] After years of trying unsuccessfully to get the California legislators to make reasonable changes to the UCL, California's business community, led by small business, ran a ballot initiative known as Proposition 64, which was overwhelmingly approved by California voters by a 58.9% margin. Thankfully for California's small business owners, shakedown lawsuits are pretty much a thing of the past.

Unfortunately, however, state consumer protection laws in most of the country, though not as inviting as California's pre-Proposition 64, still provide plenty of incentives for plaintiff's lawyers and their clients to pursue specious litigation: treble damages, statutory damages, mandatory attorneys' fees, punitive damages, and little to no standards for class actions. These types of incentives are often more than enough to entice baseless and unmeritorious claims seeking monetary damages disproportionate to any loss, if there was any loss at all. In addition, many state statutes do not require that the plaintiffs saw or relied upon the deceptive or unfair practice that is the basis for the claim.

The fundamental flaw with most state consumer protection statutes is that they often do not require elements that are fundamental to bringing a private lawsuit:

- The plaintiff experienced an injury – a loss of money or property – stemming from the purchase;
- The plaintiff saw or heard an advertisement or was subject to allegedly unfair or deceptive conduct;
- The plaintiff was misled or deceived by a representation made; and
- The deception led the person to act in a way that he or she otherwise would not have, such as purchasing a product or service.

[12] In early 2003, California Attorney General Bill Lockyer filed a Section 17200 lawsuit on behalf of the state against the law firm involved in suing restaurants and automobile repair shops for abusing Section 17200. *Id.* Ultimately, the lawyers involved surrendered their licenses, rather than face disciplinary proceedings. *See* Traci Jai Isaacs, *Litigious Attorneys Give Up Licenses*, DAILY BREEZE (Torrance, Cal.), July 12, 2003, at A3.

Consumer protection laws have strayed from their intended purpose. Rather than provide assistance to ordinary people who are duped by a seller's fraudulent conduct into making a purchase, today, consumer protection laws are the new tool-of-choice of personal injury lawyers to target small business.

Conclusion

The $65 million lawsuit over a lost pair of pants plainly illustrates how small business is vulnerable in today's civil justice system. Poorly constructed consumer protection laws allow unscrupulous plaintiffs to file specious litigation, and, because of the weakening of Rule 11, small business does not have the necessary weaponry to fight back. Congress has an obligation to review and make changes to appropriate laws to ensure that a $65 million lawsuit over a lost pair of pants is never filed again.